BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates,	Docket No. G02-45

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P R O C E E D I N G S

JUDGE FINKLE: Ready to proceed?

MR. MITCHELL: Yes. We have one preliminary matter, Your Honor. There was some discussion among counsel on Friday about the fact that Exhibit S-86, which consists of portions of the letter written on October 15th of last year, was not complete and we discussed with counsel the possibility of submitting the full letter in case somebody wants to see the context in which the excerpt appears. I believe that is unobjectionable. We propose to offer Exhibit P-21, the full version of that correspondence and its attachments.

MR. HAMJE: No objection.

MR. MADDEN: No objection.

MS. McCULLOUGH: Your Honor, we have just one small housekeeping matter. At this time we would ask the Intervenors' remainder of their time saved, 20 minutes, to the Washington Intervenors.

MR. KELLY: Well, I think the -- I think it is unfair to start swapping time. The witnesses -- each side should be held to the time that they have allocated, and the Intervenors decided to allocate it a certain way, they should be held to it.

JUDGE FINKLE: Do you have any opinion?

MR. HAMJE: We have no objection.

JUDGE FINKLE: I am going to allow it. It was originally allocated 40/40/20, and there was an internal reason for reallocating apparently. And if that's been worked out, I have no problem with putting it back the way it was expected to be at the start of this hearing.

MS. McCULLOUGH: Thank you.

JUDGE FINKLE: Any other preliminary issues?

MR. MITCHELL: One other one, Your Honor. Exhibit P-178 was an excerpt from the text called Modern Industrial Organization by Carlton and Perloff. You will recall, there was a request to make that excerpt more complete. We have the more complete exhibit here, and I would propose to offer it at this point.

MR. HAMJE: May I inquire, just to refresh my recollection, in connection with which witness's testimony was this involved?

MR. MITCHELL: I will let Mr. Townsend speak of that.

MR. TOWNSEND: Excuse me. This was the exhibit that was offered in connection with Dr. Leffler's testimony, and also Mr. McCarthy's, and it is the one that we worked out the agreement on on Friday and your assistant Ms. Nelson prepared this. Okay?

MR. HAMJE: OIC staff has no objection.

JUDGE FINKLE: Admitted. That will be substituted. Thanks.

MS. HAMBURGER: One more housekeeping matter here. We have our pro bono counsel from Covington and Burlington, Kurt Calia, will be appearing during the direct examination of Aaron Katz and David. I just wanted to introduce him.

JUDGE FINKLE: Good morning. All set to proceed?

MR. MADDEN: We are ready. The Intervenors call Steven Larsen.

STEVEN LARSEN, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MR. MADDEN:

Q. Good morning. Mr. Larsen, would you tell us your full name and professional address, please.

A. Steven B. Larsen, and I am a partner at Saul Ewing, which is a law firm in Baltimore. The address is 100 South Charles Street in Baltimore, Maryland.

Q. Before you were with the Saul Ewing firm, what did

you do?
A. I was the insurance commissioner for the state of Maryland.
Q. Could you give Commissioner Kreidler a brief summary of your training and experience as relevant to the issue of conversion of not-for-profit health carriers to for-profit status?
A. Well, we had a non-profit plan in Maryland, it was a three-state plan, actually CareFirst, which was the DC, Maryland and Delaware affiliated organizations, that attempted to convert to for-profit status and be acquired.
And I supervised and oversaw the review of that under our conversion statute and devoted the vast majority of my time personally to reviewing that and conducting the examination, reviewing the documents.
Q. As a housekeeping matter, Mr. Larsen, you provided us with a copy of your curriculum vitae; is that correct?
A. Yes, I have.
MR. MADDEN: And that's Intervenors' Exhibit 12, Your Honor, and we would offer it at this time.
MR. KELLY: No objection.
JUDGE FINKLE: Admitted.
Q. Mr. Larsen, through your experience as Insurance

Commissioner in Maryland -- and, in particular, with CareFirst -- have you gained any particular knowledge or experience regarding the conversion of non-profit health plans to for-profit status?

A. Well, certainly in the context of reviewing the CareFirst deal we spent an extensive amount of time looking at their lead up to the conversion and also looked at a number of other states that had gone through the conversion process prior to the CareFirst situation.

Q. In particular, have you -- did you study the behavior of CareFirst and other converting companies in the period of time leading up to their announcement of an intent to convert?

A. Well, yeah. CareFirst was the dominant healthcare company in the state of Maryland, and as a consequence, we spent a lot of our regulatory attention on that. So, for example, I personally reviewed rate filings and form filings that came in with my actuary, but we spent a lot of time negotiating with and talking to CareFirst about how they made rates and the rate filing process in particular, as well as other carriers in the state, for-profit and non-profit, Manze, which is for-profit, Kaiser, which is non-profit.

Q. In connection with the CareFirst conversion, did you study any other conversions that had preceded that

CareFirst?
A. We certainly looked at what had happened in Kansas -- although the circumstances weren't identical there -- but that was going on while we were looking at CareFirst. We looked at Missouri, continued to kind of track what was happening in North Carolina. We looked at what had happened historically in California, because the inquiring plan for CareFirst was WellPoint, and they had converted back in California.
Q. Since you have left office, have you kept up-to-date with what's going on, other than here in Washington, with respect to proposed Blue plan conversions?
A. Well, I have continued to monitor through the trade press what's been happening and certainly have had a number of speaking engagements and presentations related to conversions with a number of organizations.
Q. Could you just give us a sampling of some of the groups to which you have spoken regarding conversions?
A. I did a panel for the American Health Lawyers Association, for the American Bar Association, NAAG, National Association of Attorneys General, State Charity Officers. The Milbank Memorial Fund put on a seminar for a number of policymakers around the country, which I presented at.
Q. You have offered prefiled testimony in this matter;

is that correct?
A. Yes, I have.
Q. And do you adopt that written prefiled testimony as your sworn testimony today?
A. Yes. I do.
MR. MADDEN: We would offer Intervenors 11 at this time.
MR. KELLY: No objection.
JUDGE FINKLE: Admitted.
Q. Your prefiled testimony incorporates, does it not, the report which you filed with the Commissioner in this matter last November; is that correct?
A. That's correct.
Q. Do you adopt that report as part of your testimony today?
A. I do.
MR. MADDEN: We would offer Intervenors 13 at this time.
MR. KELLY: No objection.
MR. HAMJE: No objection.
JUDGE FINKLE: Admitted.
Q. Mr. Larsen, in your analysis of Premera's proposal to convert, have you focused on any particular factor or factors under the Washington Holding Company Acts?
A. The report that I did focused primarily on one of

the factors relating to whether the transaction was -- I think the terminology was hazardous or prejudicial to policy holders.

Q. Does that factor overlap with any other factors in the Washington Holding Company Act as you read it?

A. Well, in my view, it does. In my view, they kind of all revolve around the same concept, which is whether it is in the public interest. But whether it is fair and equitable, whether it is in the public interest, to me, all involve looking at the same types of issues, whether there is an adverse impact on the policy holders or the insurance-buying public.

Q. Is that the standard which you applied in Maryland?

A. We had a general public interest test, and under that test there were a number of individual factors that we were required to at least consider. And they were essentially the same factors, was it fair, was there going to be a substantial adverse impact on the availability or affordability of health insurance. And again, that involves looking at rates and lines of business and things like that.

Q. And in other instances, where Blue plans have attempted to convert, are you aware of how insurance commissioners have looked at this public interest element that you have identified?

A. Well, I think it was pretty much the same thing in Kansas. For example, where the Commissioner reviewed the deal there under her Holding Company Act. And, as I recall, she looked at a couple factors, such as whether rates were going to increase in her view and what was going to happen to surplus. And she found that those -- whether it was a hazardous or prejudicial to policy holder test or a public interest test or a fairness test, the same factors would apply, whatever tests you were going to be looking at.

Q. In light of the standards that you have identified in the Holding Company Acts, would you please summarize for the Commissioner the factors, which, based on your experience, you believe are most important for his consideration in these proceedings.

A. Well, I guess the report focused on a couple of issues. First, that while on a day-to-day basis the operations of a non-profit and for-profit company may appear to be similar, they are driven by different fiduciary duties and different objectives. And that it just has to be recognized that there will be a shift in focus and attention and duties by the management and board of the company. From a duty to the mission, to the non-profit purpose, to a duty to satisfy the shareholders and investors and to maximize value for

those investors. So that was, I think, the first point we made in the report.

And then we took that kind of overall assumption and applied it to the circumstances that we saw -- that I saw in Washington state. And in particular, in looking at the eastern Washington market -- in which Premera is by far and away the dominant health carrier there, within some lines of business, 80 or even 90 percent of the market. And in my view, the combination of those two factors, in particular, create a risk that Premera will engage in activity to essentially exploit that market advantage, and that could be through rate increases, provider network restrictions, provider compensation restrictions, among other things.

Q. Let me back you up to the assertion that corporate behavior will change with the shift of for-profit status. In the CareFirst conversion proceedings, was that assertion addressed by CareFirst?

A. Well, when you say addressed, I am sorry --

Q. Let me rephrase the question. In the Maryland proceedings over which you presided, was the issue of whether the company's behavior would change as a result of shift to for-profit status addressed by the company or its consultants in the course of those proceedings?

A. I would answer this way; their own consultants, in

the context of submitting reports, in support of the transaction, I think freely acknowledged that the duties and obligations of the management of CareFirst would change in a for-profit regime, and that their duties and obligations would first and foremost be to the stockholders, and that would result in operational changes at the company.

Q. Who are those consultants?

A. That was Accenture.

Q. Are there examples in other regulatory proceedings involving Blue plans where the issue of change in corporate focus, resulting from not-for-profit versus for-profit status, has been discussed by companies?

A. Well, in our -- I drew a connection in a couple of cases from some regulatory proceedings. Just to the north of us in Maryland, up in Pennsylvania, for example, the insurance commissioner there was having hearings about whether the Blues -- the non-profit Blues plans there had accumulated excess profit.

And they came in and testified at length about their non-profit mission and how they managed to the non-profit mission and do things, for example, like subsidize and cross-subsidize certain products to try and keep them affordable.

And we had testimony in Maryland, I think contrasted

to that, when Leonard Shaffer, the head of WellPoint, came in, and said it was -- in his view -- unethical to cross-subsidize products if you are a for-profit company.

Q. In this regard, have you had the opportunity to review the testimony of Premera's Brian Ancell in these proceedings?

A. Yes.

Q. And in terms of the point that you were making about cross-subsidization, did you draw any conclusions from Mr. Ancell's testimony?

A. Well, just that his testimony regarding that issue pretty much tracked, I think, what we had heard from Leonard Shaffer, which you are not going to see a cross-subsidization -- that they are not going to do that.

Q. In your review of Blue plan conversions, have you looked at whether there is a pattern nationally, in terms of whether converted Blue plans have remained independent following conversion?

A. Well, I don't know how to describe what a pattern is, but it certainly is a frequent occurrence that once converted and having stock that's publicly traded, those plans are then subject to being acquired, whether it is RightCHOICE or Cerulean or other plans, that's a fairly

common occurrence. I would probably describe it as the exception that they continue to be stand-alone plans for any length of time. I think, at this point, WellChoice is one of them that continues to be, but I don't think that's the rule.

Q. Based on your experience, how do converted health carriers attempt to produce a return to investors?

A. Well, I mean, they want to maximize value. And the way to do that ultimately is to maximize your margins, your net income.

And there a number of different ways to do that. You can either increase premiums with a given medical expense, or keep premiums constant and cut medical expenses or cut administrative expenses. But, at the end of the day, you are trying to bring up your operating margins.

Q. Well, isn't it asserted by Blue plans that profits can be generated by top-line growth?

A. Yeah. I mean, a common refrain that we heard was, for example, 15 percent top line and 10 percent bottom-line growth, increase revenues, increase margins.

Q. In the Maryland proceeding, did CareFirst provide you with an economic impact analysis of its business plan?

A. Well, they did provide something that they called an

Economic Impact Analysis, which they were required to do under our conversion statute. It really didn't though look at what the specific impacts -- at least in my view -- were going to be in Maryland. I think it had Accenture looking at Georgia and Connecticut and then said, well, this is what we thought happened there, so this is what we think will happen here. I didn't find that particularly helpful, but that's what they did.

Q. In your view of other conversion proceedings, did you see cases where the plan requesting to convert had provided a more detailed Economic Impact Analysis?

A. Well, again, I think in the proposed acquisition of Kansas by Anthem, I think that was an example where there was, I think, a more -- frankly, a candid but detailed Economic Impact Analysis where the projected margins that were going to have to be achieved post-acquisition were laid out. The plan detailed what was going to happen to their surplus levels.

So I think that would probably approximate what would be a more detailed Economic Impact Analysis by the plan that was proposed in the action.

Q. All right. Let's go back to the techniques whereby you say that converted companies can generate profit. You mentioned rate setting. I wanted to ask you, aren't rates regulated?

A. Well, my understanding of Washington law for the individual market is that they are largely unregulated, at least in my opinion. There is no prior approval, for example, by the insurance commissioner. There is a minimum loss ratio requirement that's in the law that I think is 74 percent or 72 percent when you are building the premium tax.

So there is some level of regulation, but there is not -- at least compared to what we have in Maryland and other states -- not extensive rate regulation.

Q. What is the role of medical trend assumptions in rate setting?

A. Well, medical trend assumptions serve as a fundamental part of the rate setting process. And it is certainly something that is subject -- at least in my experience -- to negotiation and discussion, in our case, between the plans that we regulated and the department, but they play a critical role in setting rates.

Q. Could you explain a little further, how -- in your experience, for instance, dealing with CareFirst, did you draw any conclusions as to how, if at all, CareFirst used medical trend assumptions to attempt to justify a particular rate?

A. Well, one of the jobs of the actuary is trying to

figure out where the medical costs are going to be in the future, because you want to make sure your premiums are covering those costs, and in some cases, rating ahead of the trend if you want to make more money.

But there are different ways to pick what a trend is. We had situations where, after a six-month spike in medical costs, they would come in looking for a new rate increase based on just the prior six-month trend. And we would frequently discuss with them the fact that -- at least as I was told by our actuary -- six months in general from an actuary standpoint is not a trend, and we wanted to see a longer claims experience before we were going to look at rate increases.

So I guess the point is, in many cases, we found that their rate setting process tried to aggressively use the trending process to bring the rates up more quickly than we thought were justified.

Q. Let's shift to the contracting side, provider reimbursement. Premera has said that network adequacy standards are a safeguard against unfair contracting practices, is that true, in your experience?

A. Well, I guess I have two answers. One, it has been my experience as a regulator and certainly at the NAIC and talking with many other regulators, that although many states have network adequacy laws to various

degrees, my experience is that they are frequently not really enforced by the regulator. That's kind of the general comment.

And I think in Washington there are a number of provisions in Washington law that relate to network adequacy. They seem to largely leave to the discretion of the health plan what those standards are, but the plans are required to have standards.

Q. Mr. Larsen, in this hearing there has been discussion and indeed introduction into evidence of a couple of studies that have been done attempting to compare the behavior of for-profit and not-for-profit plans. One of those is the Feldman, Wholey and Town Study, which is Premera's Exhibit 26. And the other is the Hall and Conover study, which is Premera's Exhibit 28, I believe. Are you familiar with those two studies?

A. Yes.

Q. Why is it that you are familiar with them?

A. Well, I am familiar with the so-called Feldman report because Professor Feldman prepared that at our request in the context of the CareFirst conversion. And the Hall/Conover report I have just read in the context of keeping up with kind of what's out there on conversions.

Q. Okay. Well, speaking then to the Feldman, Wooly and

Town study, could you comment on the quality of the data and the conclusions in that study?

A. That's a very high-level report, meaning that it aggregates data nationwide from a source that pulls together HMO information. One of the limitations is that it is HMO only, and of course, I think in most states in these days, the HMO is not the predominant delivery system.

The data, I think, in that report went back to 1986, covers a long period of time. And I think when Professor Feldman was testifying at our hearing about the limitations of the report, he said that a lot of the conversions that were occurring at that point were financially-troubled HMOs.

And I think the last, I guess, concern that I had with it as a regulator, is that it looked at changes in premiums, among other things -- pre-imposed conversion HMOs -- in the aggregate, and didn't break it down into market segments, such as large group, small group and individual. And I think, as my report indicates, in the context of conversions it is particularly, I think, important to focus on the impacts of the individual and maybe to a lesser extent a small group market. But this report aggregated all the data, so I didn't -- it didn't really do much for us.

Q. Following up on your comment about the need to look at particular markets, if Premera is allowed to convert, are there adverse effects that you believe they are likely to experience in certain markets here in Washington?

A. Well, I think the market conditions that exist in eastern Washington certainly create a significant risk for some of the things I talked about, either premium increases -- and I think the data that I looked at showed that there are -- the individual market, for example, in the state, as a whole -- and I believe in eastern Washington -- is not currently profitable. There are, I think, target margins for that market that range in the three to four percent in the coming years. So I think there is certainly a risk there could be premium increases there.

Without any competition -- competition -- in fact, the Feldman report talks about how competition is one of the most effective moderators of rate increases, and there really doesn't seem to be any meaningful competition in those markets in eastern Washington. So I think that's a potential risk, as is the status of the provider networks. The provider networks -- the providers really had no one else to turn to from a plan standpoint to get business. If they are not going to be

in the Premera network, they don't have many other options.

Q. Does the presence of the statutory restriction in the individual market that -- to maintain a 74 percent medical loss ratio -- mitigate this effect at all in your opinion?

A. To a small extent, but not to an extent that would give me comfort as a regulator that we can ensure there aren't going to be any large rate increases.

Q. Are there other factors in Premera's existing book of business that are concerning to you in terms of likely prejudicial or hazardous consequences of conversion?

A. The one area that I saw through my review of the reports, and some of the other data, was the existence of separate books of business in the individual market that Premera carries, one through the LifeWise entity and one through the Premera entity.

As I understand it, when there were difficulties in the individual market, a number of plans decided to stop writing the business. Premera continued to renew that business, but didn't take any new members. And then when they got back into the market they sell through another affiliate.

So you have got this old -- what we call the old

book of business over here, in which people are getting older, and sicker, generally, as people do -- and as I discovered as I get older. And there aren't any new members coming in to mitigate the experience of that book, and then you have got a lower price product in LifeWise.

And I think that circumstance creates a -- I think, a tremendous potential risk to the policy holders in the old book of business. Because, unless there is some cross-subsidization allowed and built into those rates, those rates are just going to spiral upward, at which point those people are going to be faced with great difficulty in that they are getting sicker.

I think that's a real risk, and I think there will be pressure -- internally, and from just the investor aura that's out there -- to make all books and lines profitable, and this one will not be unless there is significant rate increases.

Q. Did you look at Premera's proposal to transfer 100 percent of the initial stock of new Premera to the charitable foundations?

A. Yes. I have looked at the material in connection with that.

Q. Are there aspects of that proposal that raise concerns, in your mind, as to whether it is likely to be

hazardous or prejudicial to the insurance-buying public?
A. I guess my observation on that is at a fairly high level, and it is simply this: To me, as a former regulator, I would want to know, in order to determine whether fair value was in fact being transferred, what the value of the asset was that was being transferred.

The approach that we went at it in Maryland was that there are potential negative effects that may occur because of the conversion, you may have people dropping out of the market. And you need to know what the capacity is of the new foundation to maybe mitigate those effects. And to know the capacity, you have to know how much money is going to be over there and what they can do with it.

To my knowledge, in this case, there has been no formal evaluation of Premera. I know the concept is that you transfer the stock over, and just doing that guarantees that there is fair value, but that may not necessarily be the case.

I know, in Maryland, we used the example of you may have a house that you want to sell and you put it on the market, but first you get an appraisal to find out what you ought to be expecting when someone comes in to make an offer. And you may decide if the market is down that you are not going to sell your house because you can't

get what you think it is worth.

And I think -- again, it is a very broad analogy, but I think the concept is the same here. You want to know what the fair value of this asset is to make sure you are getting the fair value, or there is a mechanism in place to make sure you are going to get the fair value, through the IPO in this case.

Q. Did you, in Maryland, have an evaluation done on your behalf of CareFirst?

A. We did. The circumstances there were not identical because it wasn't an IPO, it was a sponsored conversion. But nonetheless, we had our investment bankers do an evaluation. They produced an evaluation range for us, and it turns out that we didn't need it because we didn't approve the deal. But we did have a formal evaluation done.

MR. MADDEN: Thank you, Mr. Larsen. Those are all the questions I have on direct.

MR. KELLY: Thanks, Mr. Larsen, my name is Tom Kelly --

JUDGE FINKLE: I am sorry. I just wanted to make sure we agree on the batting order here.

MR. HAMJE: I have no objection to have Premera go first.

MR. KELLY: Actually, let's let him go

first. I didn't mean to speak up.

MR. HAMJE: Well, then if I could proceed.

JUDGE FINKLE: That would be fine.

CROSS-EXAMINATION

BY MR. HAMJE:

Q. Mr. Larsen, my name is John Hamje, I am a special assistant attorney general, appearing on behalf of the OIC staff. Good morning.

A. Good morning.

Q. I just have a question that came to mind during your testimony, but I wanted to ask you about -- you talked about top-line and bottom-line growth. Could you define what you mean by top-line growth and bottom-line growth.

A. Top line, as I understand it, is just flat revenue growth. Bottom line would be income growth. They may not always move in tandem because a number of things are going to affect what the bottom line is, what your profit is going to be. So you are always looking to increase revenue and also increase income.

MR. HAMJE: That's all I have. Thank you, sir.

CROSS-EXAMINATION

BY MR. KELLY:

Q. Good morning. Again, Mr. Larsen, my name is Tom Kelly. Just a few questions. Let me start with a little about your background. You are not admitted to practice here in the state of Washington; is that correct?

A. That's correct.

Q. And you do not hold a degree in economics; is that true?

A. That is true.

Q. When you are referring to eastern Washington, for example, in your testimony in your report, you are relying upon the work of the PwC consultants on their economic impact report or analysis that includes the model; isn't that true?

A. In terms of figuring out what's eastern and western?

Q. Correct.

A. Yes.

Q. Okay. And you understand, for example, that market share, in and of itself, does not demonstrate market power?

A. Your question is do I understand that?

Q. Do you understand that to be the case?

A. I am not sure I would agree with that.

Q. Okay. Now, since you left the Maryland Commissioner's office, you have now registered as a lobbyist for the Maryland Hospital Association; is that correct?
A. They are one of several clients in connection with a push for malpractice reform, yes.
Q. And you have also registered to represent, as a lobbyist, the Maryland State Medical Society; is that true?
A. That's correct.
Q. Now, you are not categorically opposed to conversions, are you?
A. No.
Q. So it depends on what the applicable law is and what the facts and circumstances are; is that correct?
A. I think that's a fair statement.
Q. And the Washington law is different from the Maryland law, is it not?
A. It is.
Q. In Maryland, the applicant entity seeking to convert has the burden of proving that the transaction would actually benefit the public interest; isn't that true?
A. I am not sure I would agree with that exact description, but the burden of proof is on the movement to show that it is in the public interest.

Q. Okay. Let's look at some of the facts and circumstances in Maryland. One of the facts and circumstances in that case that led you to conclude there shouldn't be the transaction was that CareFirst was not going to remain an independent company, but it was in fact going to be immediately acquired by WellPoint; is that true?
A. It was a consideration, yeah.
Q. So the key administrative and management functions were going to be moved to California at that time; is that true?
A. Some were, correct.
Q. And another concern, as I understand it, that you had, that led you not to approve the transaction, was that there were change-in-control provisions that were going to be triggered by the very conversion itself; isn't that the case?
A. Yes.
Q. And also, in addition to WellPoint trying to acquire CareFirst, there was another suitor, Trigon, was there not?
A. There was.
Q. And you found that the CareFirst board hadn't given Trigon a sufficient opportunity to make a better offer than the one that CareFirst ended up taking from

WellPoint; isn't that true?
A. Well, I guess the short answer is no to the question you asked.
Q. Okay. Well, was there a concern about whether the CareFirst board had left some money on the table in accepting the WellPoint offer?
A. Yes. We criticized the board for the manner in which they conducted the auction for their company.
Q. Now, in regard to the evaluation, in Maryland there was actually an acquisition or a sale that was going on; is that correct?
A. Yes.
Q. Okay. That's not the case in this state, conversion, do you understand that?
A. Currently, that's correct. It is a different type of transaction.
Q. Okay. And just one final area, do you agree -- excuse me a minute. You indicated that you thought that the old Premera individual business is closed, did I hear that correctly?
A. I may have said that. I guess, to me, it has the characteristics of a closed block. And I say that only because I know that the premiums are quite a bit higher than for the LifeWise product.
Q. Well, the fact of the matter is that the book is not

closed; correct?
A. Well, they continue to renew business, and I believe they -- someone could still buy a product, I believe.
Q. Well, isn't there a -- isn't it a fact that the OIC has stated that subsidization is impermissible?
A. I don't know that.
Q. Okay. Turn then to one final area, and that's the area of risk-based capital. You do agree it is important for insurance companies to be sufficiently capitalized and to have strong surplus, do you not?
A. Yes.
Q. Do you agree that it is a legitimate goal for Premera to seek to raise its RBC level; correct?
A. Theoretically or currently?
Q. Well, actually. Isn't it actually --
A. There is a point at which you don't have to do it.
Q. Understood. Well, in the current context, do you think it is an appropriate goal for Premera to try and get up to where it currently is at the bottom end of the --
A. Yes, I agree.
Q. And you do agree, by the way, that the RBC level is considered to be at the low end of the Blue Cross plans?
A. Yes, I think it is at the low end.
MR. KELLY: Excuse me.

Q. Now, it is not your position in regard to network adequacy -- you testified a little bit about that -- it is not your position that the OIC doesn't review those network adequacy issues, is it?
A. Well, I certainly believe that the way the statute is written they may have the authority to do that. Whether they do it and what they do with that, I can't testify to.
Q. One way or the other; is that correct?
A. Correct.
MR. KELLY: That's all I have, thank you.

REDIRECT EXAMINATION

BY MR. MADDEN:
Q. Mr. Larsen, in connection with CareFirst at the time it was seeking to convert, do you recall what its RBC was?
A. It was also at the low end. I don't remember whether it was in the high 300, low 400 range, but I would say -- that was one of the arguments that was presented to us in Maryland, that they had a relatively low RBC level and needed to convert.
Q. Now, last Friday there was some testimony from Mr. Cantilo in response to Premera's questions about legislation in Maryland, attempting to change the

make-up of the CareFirst board of directors. Are you familiar with that situation?

A. Yes.

Q. Without taking an undue amount of time, where did that ultimately end up?

MR. KELLY: I would like to -- I am sorry, did you finish your question?

MR. MADDEN: Go ahead, I am done.

MR. KELLY: I would like to object, it is beyond the scope of cross.

JUDGE FINKLE: Overruled. I will allow the open-end direct.

A. It depends on what your definition is of undue amount of time. But I guess the short answer is that after we denied the deal, criticized the board, the legislature passed a statute that, among many other things, would have required that 12 of 21 members of the board be taken off and have a new set appointed by a nominating committee. And that provision was strenuously objected to by the Blue Cross Association.

I, while I was still Commissioner, actually kind of coordinated the negotiations with the Association for a short amount of time. We tried to reach a resolution with them. They -- I guess -- I don't know how to say it -- they declined to do that and indicated the only

way we were going to resolve it is if we went to court. So we went to court and we resolved it.

Q. What was the resolution?

A. It was modification. The way it worked out was, rather than having all 12 nominated by the nominating committee, the nominating committee nominated five, the five went on the board, and then the remaining board with the new five then picked the next seven.

So we did get a change-over of the 12 of the 21, but it was in a slightly different way. We ended up with somewhat less control over the process -- "we" being the state.

Q. Following the denial of its conversion application, have you followed the financial performance of CareFirst?

A. Yes.

Q. And what has been that performance?

A. Well, it has been interesting. Because, in the context of the conversion, they pled the necessity of the conversion and how it was going to be critical to their financial success. And then they, like many other plans who ended up pricing ahead of medical trends I think had one of the best years they ever had. I think their net income almost doubled for the 2003 period.

MR. MADDEN: Thank you. Those are all the

questions I have.

MR. HAMJE: No further questions.

MR. KELLY: Nothing further.

JUDGE FINKLE: Okay. Thank you. Please, step down.

MR. MADDEN: We will call Leo Greenawalt at this time.

LEO GREENAWALT, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MR. MADDEN:

Q. Mr. Greenawalt, would you state your full name and professional address, please.

A. Leo Greenawalt, 300 Elliott Avenue.

Q. That's in Seattle?

A. Seattle, yes.

Q. Would you please tell us your occupation and responsibilities.

A. I am the President of the Washington State Hospital Association, a position I have held for 23 years. And the Hospital Association represents the hospitals in the communities they serve.

Q. How many members do you have?
A. About 95.
Q. How many of those are not-for-profit?
A. A little bit over half are not-for-profit. And almost half are governmentally-run facilities, public district hospitals.
Q. Let me put it another way. How many for-profit hospitals are there among your membership?
A. I think there are only two.
Q. You have provided us with a copy of your curriculum vitae?
A. Yes.
MR. MADDEN: We would offer Intervenors Exhibit 15 at this time.
MR. HAMJE: No objection.
MR. MITCHELL: No objection.
JUDGE FINKLE: Admitted.
Q. Mr. Greenawalt, you have also provided the Commissioner with your prefiled written testimony in this matter; is that correct?
A. Yes.
Q. Do you adopt and affirm that as your sworn testimony today?
A. Yes.
MR. MADDEN: We would offer Intervenors 14.

MR. HAMJE: No objection.
MR. MITCHELL: No objection.
THE COURT: Admitted.
Q. Mr. Greenawalt, what is the position of Washington hospitals with respect to Premera's proposal to convert to for-profit status?
A. We had a number of board meetings, including our full membership with a -- debating the issue. About two-thirds of the members voted to oppose, I believe only 4 of the 95 supported, and the remaining were neutral.
Q. What are the concerns that your members have expressed about the conversion proposal?
A. I think the best description I can give is one of the hospital CEOs gave after listening to a presentation on the issues. It was -- there is -- basically there is a no-free-lunch question out of all of this. They looked at how would Premera increase its operating margin and looked at a number of issues.

One is, certainly it could increase the premium price. It sort of ignored the question of investments, saying that was more of a neutral issue. Premera could improve on its underwriting. By that they mean that those that are riskier for health issues could be excluded.

And we had a pretty startling example of that just last -- last couple of weeks, at Moses Lake, I was at a presentation and a woman came up and talked about how she had been healthy most of her life, but they discovered a cardiac problem that had been there from birth. It was fixed, and when she went out for health insurance she couldn't buy it. So it is an example how difficult it could be in this market.

One of our concerns in the hospital is that that could get worse, underwriting could get more severe than it is now.

The other way is that Premera could certainly improve on its operating expenses, but we can't see any evidence -- looking at Trigon and WellPoint and a number of others -- that their operating expenses are any lower than anybody else's. So there is no sign that this will work. As a matter of fact, Premera's operating expenses are at the middle to efficient. So no sense in that.

And the final one is that they could greatly decrease the amount of money they are paying to hospitals and doctors.

Q. And in the Association's review of the conversion proposal, did you find any evidence that caused you concern regarding the amount of pay for medical care?

A. Well, I think one of the most worrisome parts of all

was reading Brian Ancell's testimony. I think he really hit it right on the button what the issue is. He makes a point -- an understandable point -- that Premera cannot continue to cross-subsidize as it has in the past, and it cannot continue to pay for the cost of Medicare underpayment and Medicaid underpayment, that there has to be some limit on that.

And I would say, from the hospital's concern, that is really the heart of the issue, that Medicare and Medicaid were clearly put in with an understanding they wouldn't pay the full freight. And we have got a system in place that's been going on for 40 years now that shifts costs to the insurers.

Whether it is right or wrong, I can't comment. What I can say is that if a private organization starts making the decisions as to which of those costs they are going to recognize, and if it causes some kind of cascading event where Group Health and Regence start making the same kinds of decisions for competitive reasons, we have a healthcare system that goes into crisis.

Q. Could you please describe for us a little bit the characteristics of Washington hospitals that you believe are relevant to the Commissioner's consideration here?

A. Well, I would say the first one is that Washington

hospitals, by any definition, are among the most efficient in the country. By length of stay, they are third or fourth lowest, by admission rate they are among the seventh or eighth lowest. In fact, a couple of years ago, Donna Chalala was out here and she was quoting Joseph Califano, kind of tongue in cheek, but actually accurately, saying that if we could fly all the Medicare patients from Florida and New York first class to Seattle, they could have a wonderful experience, better outcomes, and it would be a lot cheaper. What is really clear, is that this system, the state of Washington, the hospital system, is the about the most efficient in the country. So we are not talking about fat running through the system.

Q. What --

A. Just one other thing. We are predominantly a rural state as well. Over half of our hospitals are rural.

Q. Are hospitals -- let me ask this a different way. In terms of total operating revenue, how much comes from patient fees?

A. Almost all comes from patient fees. With the exception of the public district hospitals, who have some degree of taxation and some charitable giving in the not-for-profits, it is almost all coming from patient fees.

Q. As between public and private payers, what is the breakdown of revenue, if you know?
A. It is a little bit over a third Medicare, about an eighth comes from Medicaid. Basic Health Plan is another section of it. The federal government for their own employees is another percentage. So it is over half that's coming from governmental sources.
Q. Are the governmental programs generators of positive revenue for hospitals?
A. No. According to the Washington State Department of Health who does studies on this, the Medicare program is paying about 94 percent of the cost. I am not talking about charges, just the costs. So the hospitals lose about six percent on every patient that comes in for Medicare. With Medicaid it is about 92 percent, so the hospital loses about 8 percent. And with Basic Health it kind of varies, depending on the plan. But there was always an understanding with Basic Health the hospitals would not be able to break even.
Q. Could you comment on the situation in eastern Washington, insofar as it bears on the particular concerns of hospitals in that region?
A. The eastern Washington hospitals are really worried for a couple of reasons. One is, for a number of them, Premera is their insurer for their own employees, and

they have had no interest whatsoever from other companies coming in and bidding. So when they have gone in and asked for someone to come, they are just too small and not a good market.

The second part is, for some of the eastern Washington hospitals, where I talked about government payers being 50 percent, it is almost 90 percent in some of the hospitals, if you include school teachers, federal employees, others.

So the only place they can come close to a margin is if Premera agrees to stay in that market, one, and agrees to pay on some levels that can help them make up for those losses.

Q. Does the testimony of Mr. Ancell raise any concerns in your mind in this regard?

A. It did. It is saying that Premera cannot continue to subsidize these government programs. So it is a combination of Medicare and Medicaid shortfalls, and certainly the number of people coming into the hospital now that don't have insurance at all, bad debt and charity care, which is growing rapidly.

The essence of Mr. Ancell's testimony, which I actually agree with the essence of it, he says, it is not our fault so we shouldn't have to pay for it. But that's much too simple an answer. The concern is what

if they do stop? What if they say we are paying only for the cost of our patients? It leaves most of the hospitals in the state unable to survive.

Q. Let me ask you, what's the total amount of charity and uncompensated care that is delivered by Washington hospitals on an annual basis?

A. Well, this is a difficult figure. I have tried to be as accurate as I can in this because it is based on the Department of Health data coming out of charge information, and I have tried to use their factor for cost, but here is what I would show it to be.

For Medicare, it is $200 million that the hospitals actually lose money on the state. For Medicaid it is 80 million. For charity care it is 80 million. And for bad debt it is 130 million. So all together, it is about $500 million that the hospitals are not paid for various kinds of patients.

Q. What's been the trend with respect to that number, is it up, down, neutral?

A. The trend for Medicare for the last couple of years -- at least since the mid-90s has been -- it has gotten considerably worse because of the Balanced Budget Act in the earlier days, which sort of kicked in toward the end of this period of time. So it has been increasing somewhat, although there have been times they

were worse.

What's really growing though is the bad debt and charity care sites. What we are finding across the state -- because the recession Washington has had, worse than the rest of the country -- that the number of people without insurance is growing rapidly.

What that means is that many patients are coming to the emergency room now that used to go to a primary care physician, they don't have coverage, so they are coming there as the only place they can go.

Q. Has WSHA done any studies of this phenomenon of growth of emergency room visits?

A. Yes. I think our date was 1998, we started and finished in 2003. The increase in emergency room visits is up just a bit over 25 percent.

Q. And what did WSHA look at to determine how many of those visits or what percentage of those visits were true emergencies?

A. This may sound strange, not one of them has been a true emergency. By that I mean the number of trauma cases, true trauma, has not increased at all during that period of time. So that, we feel, is really constant during that stretch.

Q. And do you draw any conclusions about what's causing this increase in emergency room visits?

A. I think it is two-fold. One is that our state has cut back on Medicaid, it has cut back on Basic Health. The small businesses I don't think are offering insurance quite as much as they had. I think a result is that there is a large number of people that can't find a doctor, and even a larger number that don't have any health insurance at all.

Q. Mr. Greenawalt, what's the average operating margin for Washington hospitals?

A. I think for 2002 it was 2.6 percent, and for 2003 just a little bit under 4 percent.

Q. What's been the trend over the past five years?

A. Well, first, the experts that look at hospital care say that in order for hospitals to survive over the long run they have to have close to a five percent operating margin. Moody's, which does the bond rating for hospitals, says that for a double A rated hospital they have to have a seven percent margin, to give a little context to that.

Over the last five years, the operating margin has been roughly in the three percent range. I think 14 or 15 hospitals have actually lost money on average during that period of time. And about a third of the hospitals have earned five percent or more.

Q. What would be the effect on hospitals if there is

either a decrease in reimbursement or an increase in uncompensated care resulting from Premera's conversion?
A. Well, if -- in rural Washington, which is more eastern than western -- if there is a change either way, there is so many just under the thread of survival. Again, the 13 or 14 that have been losing money for a period of time, some of them during the last couple of years have gone on warrants. Because of us that don't work in government, it means in essence they go to the bank and sell a piece of script that says they can pay their employees with it. So we have a number of people across the state, employees, that get paid on that basis. Those hospitals would not survive. They are right on the brink right now.

For the urban hospitals, I think what we are finding in the Seattle/Tacoma area, is that the emergency rooms are pretty much stretched to the brink right now. We are finding diversions on a regular basis. The Tacoma hospitals are saying they can't handle any more so they are sending things to -- sending patients to Harborview. Harborview is running at about 104 percent occupancy, actually just recently converted their cafeteria -- or part of it into an emergency department.

This system can't withstand any more of that happening.

MR. MADDEN: Thank you, Mr. Greenawalt. Those are all the questions I have on direct.

MR. HAMJE: No questions. Thank you, sir.

CROSS-EXAMINATION

BY MR. MITCHELL:

Q. Good morning, Mr. Greenawalt.

A. Good morning.

Q. You have, I think, painted a pretty stark picture of a healthcare system in crisis. With respect to one of the -- one of the players in that system, the hospitals, I take it from the average that you quoted that there are some hospitals that are doing markedly better than the five to seven percent margin that has been recommended by various authorities; is that right?

A. Not better than five to seven, better than five. We have a couple that are over seven, but by and large, it is the five to seven range. If you look over a five-year period, there are a couple. I think we have three hospitals in the state that are double A rated, that's one of the lowest in the country.

Q. Let me ask you about Multicare. Is it not the case that the Multicare system in Tacoma, which got into a highly-publicized spat with Premera over demand for higher reimbursement, has margins in excess of 10

percent?
A. I don't know that answer, but it would not surprise me.
Q. Is it your testimony, Mr. Greenawalt, that the insurance-buying public, as part of their premiums, should be providing a subsidy to fund hospitals?
A. The word should is a difficult question, Mr. Mitchell. I think it is a system that was built in the 1960s and it just is.
Q. Is it your understanding in the negotiations between providers and Premera that there is any conversation about cross-subsidization, or does the conversation go along the lines of what is the market for provision of health services?
A. I am not sure I understand. Can you help me?
Q. Sure. Isn't it the case that in the conversations and the negotiations between health insurers and hospitals, the discussion is what is market-based reimbursement for this market?
A. That's only part of the discussion. A big part of the discussion also is what is the cost of delivering care, how are we handling Medicare, how are we handling the poor.
Q. In the world of healthcare costs, Mr. Greenawalt, my understanding is that some 40 percent of the healthcare

costs load comes from inpatient plus outpatient services by hospitals in Washington. Does that comport with your understanding?

A. Yes.

Q. Would you not agree with me, Mr. Greenawalt, that those costs are growing very rapidly?

A. In relationship to what?

Q. In relationship to the general rate of inflation, for example?

A. Yes.

Q. Now, one of the things that you did not mention in your prefiled direct testimony is that you participate in something called the Washington Healthcare Forum. Am I correct in my understanding that you have been working there with Mr. Barlow since the year 2000?

A. Yes.

Q. And that the mission of the Washington Healthcare Forum is to promote administrative simplification and to achieve operating efficiencies for the benefit of providers and insurers alike; isn't that true?

A. Yes.

Q. And one of the notable accomplishments of the Healthcare Forum is the One Health Port system; isn't that true?

A. Yes.

Q. Is not Premera a primary sponsor of the One Health Port system?
A. Yes.
Q. And the One Health Port system is designed to make it easier and more efficient for providers to hook up with health insurers and secure information about coverage and all other kinds of information; isn't that right?
A. Yes.
Q. Now, in your prefiled direct testimony, in paragraph 4, Mr. Greenawalt, you observed that 41 percent of hospitals find Premera more difficult to negotiate with than other payers, 41 percent of hospitals also report lower hospital payment by Premera as compared with other payers.

Am I correct in my inference that means that 59 percent of the hospitals that responded said Premera is at least as good as others?
A. I think that's correct.
Q. Now, would you agree with me, Mr. Greenawalt, that insofar as an insurer wants to build or maintain a statewide network of providers, it needs rural hospitals?
A. Yes.
Q. And is it not the case that rural hospitals in

particular occupy a relatively strong bargaining position relative to an insurer, that has as one of its primary competitive strengths maintaining a statewide network of providers?

A. If you are talking theoretically, the answer is yes.

Q. In terms of the concerns that have been expressed to you by your member hospitals, Mr. Greenawalt, have you discussed with your members the research that's been done on the effects of conversion elsewhere?

A. Yes, we have.

Q. Have you in particular discussed the Hall and Conover study, done by researchers from North Carolina?

A. I don't know that.

Q. Have you discussed with them the New England Journal of Medicine articles that was discussed here about the provisions of services to members of for-profit versus not-for-profit health plans?

A. So I don't have you going through all of those, when we were presenting to our members the issue, we went to Premera and asked them to put forth all the arguments that we ought to be using for conversion and any kind of studies, and we did ask the others to do the other side. I can't tell you which ones were used. What I can tell you is we asked Premera to give us their best information on all of that, but I don't know which

studies.
Q. That happened, as I understand it, in the fall of 2002; is that right?
A. Yes.
Q. You have not done more recent research on the subject I take it?
A. I haven't personally. I can't answer that question.
Q. You mentioned in your prefiled direct testimony, Mr. Greenawalt, that Premera's decisions with respect to Medicaid and Basic Health programs gave you concern about how for-profit entities might act in the marketplace. Do you recall that testimony?
A. Yes.
Q. In fact, is it not the case that Regence and Group Health exited those markets -- at least in certain counties in Washington -- much earlier than Premera did?
A. Yes.
Q. And it is not the case, is it, that Premera abandoned the Medicare -- I am sorry, the Medicaid business, it rather had a buyer for that business in the person of Molina?
A. That was not our -- the answer to that -- could you ask that in the negative and in the positive?
Q. Let me rephrase the question. Is it your understanding, Mr. Greenawalt, that Premera has

transferred certain of its business to Molina, it has not abandoned that business?
A. It has transferred it. The whole issue is what raises our concern of what's happening with Premera and its view of that group of people.
Q. Are you familiar with the testimony of Dr. Leffler and Dr. McCarthy regarding the potential impacts of conversion in eastern Washington and in Washington more generally?
A. I have not seen that.
Q. Is it your assumption, Mr. Greenawalt, that Premera will serve the interest of its shareholders at the expense of other stakeholders, such as its members?
A. Are you confining that to members, to its members?
Q. Well, let's start there.
A. For me, the question so misses the point of my testimony that it is hard to answer that.
Q. Let me ask the question again, if I might. Is it your testimony or is it your concern that Premera will be driven to serve the interest of its shareholders at the expense of other persons for whom it has some responsibility?
A. Yes, it is that. And my concern is that --
Q. Thank you.
A. -- their definitions of persons is broader.

MR. MITCHELL: Thank you. I have nothing further.

REDIRECT EXAMINATION

BY MR. MADDEN:

Q. Mr. Greenawalt, you were asked a question by Mr. Mitchell about the requirement to maintain network adequacy as a check on behavior in eastern Washington and you answered in theory.

What, in fact, do you hear from your eastern Washington members about Premera's negotiating behavior?

A. Well, I am sure the Commissioner has heard in its hearings on eastern Washington how worried the hospitals are and the difficulty they are having. So it has been a very tough time, both negotiating and worried about whether they are going to stay there.

MR. MADDEN: Nothing further.

MR. HAMJE: Nothing further.

MR. MITCHELL: One quick question, Mr. Greenawalt.

RECROSS EXAMINATION

BY MR. MITCHELL:

Q. Did the -- WSHA take a position against the application made by two of its members in eastern

Washington to convert to for-profit entities?
A. I am sorry, central Washington?
MR. MADDEN: Objection, it is beyond the scope.
JUDGE FINKLE: Overruled. Go ahead and answer.
A. All right. We have had a position that in a failing situation anything that keeps the hospital in the community is a good idea. In this case, we had two failing hospitals that weren't going to make it, and it was a wonderful opportunity to keep them alive.
MR. MITCHELL: Thank you. Nothing further.
MR. MADDEN: Your Honor, we intend to present the testimony of Duane Dauner by telephone, and I had him on tap for 10:30, and I have been trying to accelerate it by e-mail. But I haven't confirmed it, so I was going to lean over and ask Ms. Hamburger if there was another witness that we might be able to put on.
JUDGE FINKLE: I want to make sure you are done questioning this witness.
MR. MADDEN: I have no further questions.

EXAMINATION

BY COMMISSIONER KREIDLER:
Q. Mr. Greenawalt, there was a question in rebuttal

here by Mr. Madden that dealt with the issue that you raised relative to the theoretical relationship for negotiation by rural hospitals with Premera.

What, in practice, would you say has been the reality of that negotiation?

A. Well, part of the answer to that, Mr. Commissioner, is that in earlier times when we talked about issues such as Medicare and Medicaid and rural networks, Premera, then Blue Cross, was always in the central part of the conversation, worrying about the coverage and worrying the community.

And even back as far as 1984, when we were talking about some kind of pool, Blue Cross -- then Blue Cross -- was one of those saying we have got to find a way to get Aetna's and others into this game, because Medicare is not paying its share in Medicaid, and we worry about eastern Washington.

So what's really been interesting is those debates always took place -- and they took place as recently as 1992, when we were talking about healthcare reform. Blue Cross was one of those and Premera was one of those organizations that talked about let's make sure that this healthcare delivery system improves the health of the community. So if we have a goal in 2000, let's make it better. It wasn't this market discussion, what

great -- what drives just the cost and that side.

So in rural Washington, in earlier times, whenever Blue Cross was at the table, it was how do we make sure these communities get served. That was the first question, and they worried about that. They certainly had to worry about price.

So what they have been finding -- at least in the rural part -- is the question is much more on this market side. Is there a market, what can we pay or not pay. And very seldom do they ask the question of what is it going to take to keep this hospital alive. And what we know in many of these communities is if the hospital goes under, the town goes within a couple of years. Because it is, by far, the highest paid employees in those towns. So it has a tremendous ripple effect.

My biggest concern in all of this is that it should not be the decision of a private company on this system. It has to have some function within government of looking at these bigger questions. They grew to that percentage of business by a combination of hospitals giving them pretty good prices and by the state not attacking them. So they are there for a certain reason, and I think it has to be -- I have known -- these are the things you have stood for. This is classic mission

side issue. Excuse me for preaching.

MR. DAUNER: This is Duane Dauner.

JUDGE FINKLE: Just hold on for one minute. Thank you, Mr. Dauner.

Q. You seem to have, Mr. Greenawalt, alluded to the fact that that relationship has been somewhat frayed in the last few years. Is that in fact what you are saying, there has already been some changes in behavior from what your hospitals are experiencing?

A. Yes, there has.

Q. With Premera?

A. Yes.

COMMISSIONER KREIDLER: Thank you, very much. I have no further questions.

MR. MITCHELL: One quick follow-up if I might.

FURTHER CROSS-EXAMINATION

BY MR. MITCHELL:

Q. Mr. Greenawalt, are you familiar with the efforts that Premera has been making in coordination with the Deaconess Hospital in Spokane to resolve its fiscal crisis?

A. Yes, I am.

Q. And has that been a positive effort by Premera in

your judgment?
A. It has been positive.
MR. MITCHELL: Nothing further.
MR. HAMJE: No questions.
MR. MADDEN: No questions.
JUDGE FINKLE: Thank you. Please step down. Ready to proceed?
MR. MADDEN: Right on time. Mr. Dauner, can you hear me? This is Mike Madden.
THE WITNESS: Yes I can.

DUANE DAUNER, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MR. MADDEN:
Q. Mr. Dauner, would you please state your name and professional address, please.
A. My name is C. Duane Dauner, and my position is the President and Chief Executive Officer of the California Healthcare Association and California Association of Hospitals and Health Systems. Address at 1215 K Street, Suite 800, in Sacramento, California.
Q. Since you are testifying by telephone, would you

tell us where you are physically located at this time and whether there is anyone with you in the room?
A. I am physically in my office at 1215 K Street, and there is no one in the office with me.
Q. Would you give us a brief description of your occupation and responsibilities as CEO?
A. My responsibilities as the CEO are to manage an organization that represents and serves hospitals and hospital systems throughout California, and we are a professional trade association that provides those types of services for all of the hospitals in the state.
Q. And you have provided us with a copy of your curriculum vitae, consisting of two pages; is that correct?
A. Yes.
Q. Does that document accurately recite your credentials?
A. Yes.
MR. MADDEN: We would offer I-21 at this time, Your Honor.
MS. EMERSON: No objection.
MS. DeLEON: No objection.
JUDGE FINKLE: Admitted.
Q. Mr. Dauner, you have also provided us with written direct testimony in this matter; correct?

A. Yes.
Q. Do you adopt and affirm that written testimony as your sworn testimony today?
A. Yes.
MR. MADDEN: We would offer I-20 at this point, Your Honor.
MS. EMERSON: No objection.
MS. DeLEON: No objection.
JUDGE FINKLE: Admitted.
Q. Mr. Dauner, California went through a conversion of one of its Blue plans of for-profit status, did it not?
A. Yes.
Q. Does your organization survey its members regarding their relationships with health carriers?
A. We conducted surveys in conjunction with the -- our regional association located in Los Angeles, the Hospital Association of Southern California.
Q. And for how long have you conducted that survey?
A. We conducted those surveys for four years, and the last year that we conducted the survey was 2002.
Q. Did you conduct the survey pre-conversion of WellPoint?
A. We conducted it for four years, and that was a formal survey. We had done informal surveys and we do those periodically. Those are internal informal

surveys. The formal surveys contracted to an outside organization, were done in those years ending in 2002.

Q. What data points does your survey cover? By the survey I mean both the formal and the informal. If there is a difference, please explain.

A. The formal surveys were conducted in the years '99 through 2002, and those were contracted out to an independent firm.

Through our own internal mechanisms, we have a managed care committee. And that committee does informal surveying of hospitals, and we gain input from hospitals about plans on an ongoing basis. And it is normally done more than once a year. We have been doing that for more than a decade.

Q. What issues concerning hospital and carrier relations have you surveyed?

A. We surveyed the -- everything from payment levels to the red tape that is required, to the processes that are used, to the road blocks that are put up by the plans -- policy plans and the way they deal with providers.

If you boil it down into a short statement, it is the operational relationships with hospitals, the plans' operations relationships -- one. Secondly, how they manage the business. Thirdly, their policies. And fourthly, their payment practices and payment levels.

Q. Does your surveying allow you to compare the behavior of the current for-profit Blue plan, WellPoint, with its predecessor non-profit Blue plan?
A. The answer is yes. We compared, over the years, the operations of the plans and their relationships with hospitals.
Q. And what have been the salient points from your standpoint as the CEO of the Hospital Association in comparing the pre-conversion behavior of the Blue plan to the post-conversion behavior?
A. I think the biggest change has been in the aggressiveness of the plan and the manner in which the plan has dealt with hospitals. And that translates into all of those areas that I have just described that we have been interested in, from the relationship side, to the processes, to the actual payment and handling of claims throughout the entire process, whether they are individual claims, batch claims, outlier claims. All of those are considered.

And the rating of the for-profit plans, generally speaking, have been less than the ratings that were assessed -- that were assigned, again, based on the surveying prior to their conversion.

As a general statement, general observation about all of the conversions -- and in particular the Blue

Cross conversion -- the ratings went down significantly over a three or four-year period of time, after the conversion occurred.

Q. Have you detected any changes in the underwriting practices of for-profit plans, as compared to not-for-profits?

A. Well, historically, in our state, when the majority of plans were not-for-profit, the average of the revenues that they received in premiums that was applied to payments for services, exceeded 85 percent. And, in fact, the majority of them exceeded 90 percent in returning money to providers of the premium dollars collected.

Now, on an underwriting side, we are talking about only the premium income, not the additional interest income and other income that the third party payers see, which is not accounted in the calculation of a so-called medical loss ratio.

And after conversion, we have seen that that number dropped. And in the specific case of Blue Cross, for the last several years, they have been below 80 percent. The latest reports showed them at 79 percent, which has been about where they have fallen over the last few years in conversion, and they were up around the 85 percent mark prior to that.

And if you go back in history, it was up above 90 percent. They ran into some financial difficulties a few years ago, and it had dropped down into the eighties, but not into the seventies until they had converted into for-profit status.

There are, by comparison, several non-profit plans in California that are substantially higher and still maintain a 95 percent or higher rating -- Kaiser being the largest one, Scripps Clinic Health Plans in San Diego, Sharp health plans, they are all at the 95 percent level. The largest one in Northern California, Western Health Advantage, is at 88 percent as a non-profit plan.

So the difference is in a percentage, maybe six or seven or eight or nine or ten, Kaiser has a substantially greater gap between the percentage of premium income taken in and the amount that's paid out directly for patient care.

Q. Has that savings in medical payments translated to lower premiums for WellPoint?

A. No. Again, you have to look at individual companies. And, as you look at the marketplace, because of the large number of conversions that occurred in this state, the competition has taken on a different dimension than it had when all of the major plans in the

state were not-for-profit.

So it is difficult to pin it down to say one factor is responsible. However, if you look at over the years and observe when changes occurred, most of these gaps between the non-profit and private -- and the for-profit plans, have occurred after the major conversions. Because there have always been a few for-profit plans in the state. They did not determine the market, as is the case now. When Blue Cross, PacifiCare, HealthNet, Aetna, CIGNA, and others, have a rather significant portion of the market, then you end up with a different set of competitive dynamics. And that obviously affects then the way everybody behaves.

Q. One last area of questioning, Mr. Dauner. Have you had the opportunity to review the prefiled testimony of Lewis Reid?

A. Yes.

Q. Do you know Mr. Reid?

A. No. I do not know him personally.

Q. Do you have any comments on his testimony?

A. Well, I guess the one observation, he seems to equate philanthropy as being a major benefit of the conversion, and we need to look at philanthropy over, quote, charity care.

I am observing the April 23rd WellPoint Blue Cross

release that that company issued, based on the company's first order of profits this current year. And the company said that they had a $5.65 billion first quarter revenue. That would translate to nearly $23 billion for a year, and the profit was $295 million, and on an analyzed basis is about 1.2 billion.

That translated then into a first quarter distribution of 180 -- or 1.85 per share. And the company projects that the full-year profits for 2004 will be $7.50 per share.

If you think about the numbers, just the sheer numbers, if that money that is going to $7.50 per share, was going into services in California, as opposed to profits paid out per share, we would see that we are talking about hundreds of millions of dollars a year.

And when you think about what a 1 or 2 or 3 or 4 billion dollar foundation can give in philanthropy, it pales in comparison.

And the foundations can do good work, that's not the point at all. There are many people that do good work. The foundations that give philanthropy are giving in the hundreds of thousands or a few million, and in some cases, they may even give in the tens of millions. But that is a small proportion -- very miniscule -- compared to the hundreds of millions that are going out for

profits -- that are coming from the patient or from the employers and individuals that are paying premiums for healthcare.

So the real difference here is, as a social justice decision, do we want money charged to individual employers and people that are paying premiums, to have a transfer of that money paid out in shareholder returns versus paid to healthcare providers to directly deliver services to patients.

MR. MADDEN: Thank you, Mr. Dauner. I am going to turn you over for cross-examination now.

MS. DeLEON: OIC staff has no questions.

CROSS-EXAMINATION

BY MS. EMERSON:

Q. Good morning, Mr. Dauner. My name is Ramona Emerson. Can you hear me?

A. I can. Not well, but I can hear you.

Q. I will try to speak as close as I can into the microphone.

Mr. Dauner, in paragraph 4 of your prefiled direct testimony you indicate that in California insurers led by the for-profits have withdrawn from California markets because they want higher Medicare capitation payments; is that correct?

A. That is correct.
Q. Now, that isn't something that's unique to California, is it?
A. I can't speak to other plans in other parts of the country. I can speak with authority about what happened to California, and out of the 58 counties, the for-profit plans withdrew from almost every one of the rural counties because the so-called AAPCP, or the annual adjusted per capita cost payment, for Medicare capitated plans, were inadequate. And when it was adequate, that they could make the profits on it, they delivered out there. And then when the increases were, in their judgment, insufficient, they withdrew from the market and left the people without coverage, in, many times, a managed care product.
Q. Mr. Dauner, if I could just ask you to please answer the question I posed, we are on a pretty strict time schedule here.
You are aware that there has been a withdrawal of Medicare all around the country, aren't you?
A. Generally speaking, the answer is yes. I have read about it, but I can't speak with authority outside of California.
Q. Isn't Medicare the real problem and not the private insurers?

A. The California point of view, we believe that Medicare should pay a fair market value. But the fact is that there are several of the not-for-profit plans that stayed in those markets. It is also true that a few of the not-for-profit plans also withdrew.

Q. These are not-for-profit insurers leaving California markets; correct?

A. Certain segments of it.

Q. Now, in paragraph five of your prefiled direct, you make a number of generalizations about what for-profits do, versus what non-profits will do. You don't point to any studies or hard data to back up those statements, do you?

A. If you would like, I would be happy to. The state department of managed healthcare --

Q. I am sorry, Mr. Dauner. Perhaps you didn't understand my question.

MR. MADDEN: Your Honor, I object. To ask a leading question and then suggest that when you get a negative answer that he hasn't answered the question is improper.

JUDGE FINKLE: No. I think the question, as posed, should have been answered briefly. You can follow-up on redirect. Go ahead, please.

Q. Mr. Dauner, let me rephrase. In paragraph 5, you

don't cite to any studies or hard data in support of those generalizations, do you?
A. If I do not cite it in the testimony, I haven't.
Q. Now in paragraph 6 -- and you have talked today a little bit about medical loss ratios in California. Are you familiar with Premera's medical loss ratio in the state of Washington?
A. I had just observed the general information, but I am not an expert on either that company or the state of Washington. And I was responding only on behalf of what I know to be the case in California.
Q. You don't know what Premera's medical loss ratios are projected to be for the next five years, whether or not Premera converts; is that correct?
A. That is correct.
Q. You are not familiar with the regulations governing minimum loss ratios in the state of Washington?
A. No.
Q. Do you know for a fact, Mr. Dauner, that every non-profit's medical loss ratio is higher than every for-profit's medical loss ratio?
A. In the country?
Q. Anywhere?
A. Well, I can speak only to California. And if you look at the details of all of the plans, generally

speaking, the for-profit plans have a lower payout of premiums than the not-for-profit plans. There are, occasionally, an exception to that rule.

Q. Now, Mr. Dauner, you have talked about some surveys that you have done of your membership; correct? And these are formal surveys that were done between 1999 and the year 2002?

A. Correct.

Q. You haven't testified about any formal surveys that were conducted of your membership before the conversion of WellPoint took place; is that correct?

A. I don't understand the question.

Q. There were no formal surveys that were taken by your organization of your hospital members before the conversion of WellPoint took place; is that correct?

A. We did not contract out formal surveys until 1999.

Q. And the conversion of WellPoint took place in 1994; is that correct?

A. Yes.

Q. Now, you have offered some opinions that in California the benefit of foundations have not begun to offset the negative consequences of conversion; is that correct?

A. I made the statements that the foundations do good work in philanthropy, but when you compare what I just

described in terms of actual dollars, that the amount of money that goes to philanthropy is a very small proportion of what is paid out by converted plans into profits for shareholders.

And if you look at the percentages of payout of premiums before conversion, versus after conversion, that those numbers are far greater in multiples than the contributions that are made in the form of philanthropy.

Q. Yes or no, Mr. Dauner, isn't it true that one billion dollars has been distributed by the California Endowment since its formation?

A. True.

Q. Thank you, no further questions.

MR. MADDEN: No further questions, Mr. Dauner. Thank you. Maybe the Commissioner may have a question or two.

EXAMINATION

BY COMMISSIONER KREIDLER:

Q. Mr. Dauner, a question that I would have would deal with the question on the trends that your survey reported in relation to converted companies, in particular.

What do you think would have been the experience in California if those plans had not converted as

opposed to converted?

We have heard from others -- and the reason I ask the question that way, is because there is an indication that there are changes in the marketplace that would have happened with or without conversion. How would you respond to that?

A. I think the market continues to change. And the way it was in '85 or '80 or '95 or 2000 could not just be the same period of time. So you have to take into consideration the entire landscape.

If you zeroed in on conversion versus non-conversion, and look at -- let's say -- let's just take Blue Cross at 79 percent of the payout premiums, versus, let's say, the Scripps and Sharp plans that are not-for-profit, at 95 percent. If Blue Cross behaved as those two plans and paid out 95 percent of the premium income that they had directly to providers for benefits, then you are talking about literally hundreds of millions of dollars that would have gone directly into healthcare annually by that plan.

And one of the factors that is applied in the evaluations that we do is the level of payment, the processes to pay a payment, and the relationships with the plan and the negotiations over paying the range. And clearly, they would be different with respect to

that one plan if the plan was paying out 94 or 93 or 92 percent of premium income, directly to providers, versus 79 percent, because the money is in the hundreds of millions of dollars a year.

Q. So if I understand correctly then, what you are saying is that, even though there may have been a change in the Blues plan before WellPoint, it would not have reached the same level as WellPoint has today?

A. I am saying that if the plan changes in the marketplace, that's one thing. When a plan changes its philosophy of how much of its premium revenues that it pays directly to providers to deliver patient care, that's another matter.

And when we observed the facts about Blue Cross, as an example, back in the -- say, '70s and '80s, versus what they payout today, it is so significant that it cannot be ignored.

COMMISSIONER KREIDLER: Thank you, very much. I have no further questions.

JUDGE FINKLE: Any follow-up, Mr. Madden?

MR. MADDEN: No, Your Honor.

MS. EMERSON: Just briefly, Your Honor, thank you.

RECROSS EXAMINATION

BY MS. EMERSON:

Q. Mr. Dauner, is your testimony that Scripps in California has a 95 percent medical loss ratio?

A. It is. I am looking at data that was submitted for the latest year it was calculated, and it is typically 95 percent.

Q. And Scripps is an HMO model; is that correct?

A. Yeah. They are all managed care plans, yes, all regulated by the California Department of Managed Healthcare.

I guess, to be specific for you, the Scripps plan is 95.8 percent and the Sharps plan was 94.8 percent.

Q. That's also an HMO model?

A. Yes.

Q. Now, you were also -- you were asked some questions by the Commissioner about changes by Blue Cross that may have resulted as a result of the conversion.

In providing that testimony today, are you basing it on any study or any data that has been accumulated to quantify or to explain the performance of Blue Cross as a result of the conversion?

A. I think the facts speak for themselves. Just look at the numbers and it lays out quite easily, if you just say what are the facts. And you don't need to go down

and look at philosophy and look at all the other innuendos or subtleties that may be present in the individual marketplace or any of the individual companies. You can just look at hard financial facts and they speak for themselves.

Q. So you are not referring to any study; is that correct?

A. I am referring to the reports that the companies file on their financial performance.

MS. EMERSON: No further questions.

MR. MADDEN: No follow-up here.

JUDGE FINKLE: Thank you. We will let you go, and we will take a break.

(Morning recess.)

JUDGE FINKLE: Ready to proceed?

MR. CALIA: We would like to call Mr. Aaron Katz.

AARON KATZ, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MR. CALIA:

Q. Good morning, Mr. Katz.

A. Good morning.
Q. Could you please state your full name for the record.
A. Aaron B. Katz.
Q. And where do you live?
A. Where do I live?
Q. Yes.
A. 3328 37th Avenue South, in Seattle, Washington.
Q. And what do you do for a living?
A. I am on the faculty in the Department of Health Services in the School of Public Health at the University of Washington.
Q. How long have you been at the University of Washington?
A. Since 1988.
Q. Okay. Could you -- let me back up for a moment. Could you briefly describe your educational background, starting with college, please.
A. Sure. I have a Bachelor's degree from the University of Wisconsin in Madison, and a certificate of public health from the University of Toronto.
Q. And could you briefly summarize your work experience, please.
A. Sure. I have been working in the area of public policy really since I left graduate school, first in

environmental policy in the state of Minnesota. And then after I moved to Washington in 1977, I have been working in health planning and health policy since then, first for a -- the health systems agency, which is a federally-funded community planning organization, and later at the University of Washington.

Q. Could you describe your responsibilities that you have had from the University of Washington since 1988?

A. Sure. Since 1988, up until December of 2003, I was the director of the Health Policy Analysis Program in the Department of Health Services at the School of Public Health. And there I led an organization that worked on public policy issues in the health sector, it is a self-sustaining program that works primarily at the state level in the state of Washington, on a variety of public policy issues.

Q. Is the Health Policy Analysis Program sometimes called HPAP?

A. Yes, that's correct.

Q. Could you generally describe your responsibilities as the director -- former director of HPAP?

A. I was responsible for developing projects, mostly funded by contracts and grants, as well as, some self-sustaining activities, for example, conferences and the like, and for managing most of those projects.

Q. Could you describe the kinds of projects that you and HPAP were involved with over the years?
A. Sure. A wide variety of projects on a wide variety of topics in the health sector, from the financing and organization of services for people with HIV AIDS, to long-term care, to mental health, to managed care.
An example would be some evaluations that we did for the state Medicaid agency in the early 1990's, evaluating what's now called the Healthy Options Program, which is Medicaid managed care. We have provided policy support to a number of state agencies and legislative task forces and commissions that we are looking at health policy issues.
Q. How would you define health policy analysis?
A. Well, health policy is a field that looks at how we, as a society, makes decisions. That is, in government, how government makes decisions in the health sector, and how those decisions affect and influence -- in this case, the health system -- looking at how healthcare markets change, how organizations in the healthcare system relate to each other, and how government decisions effect those relationships.
Q. And in response to my last question you used the term market. What use or uses do you have in your area of expertise for the word market?

A. Well, we use the term market in a number of different ways. In the way I just used it, I am simply talking about the healthcare organizations that buy and sell -- and individuals as well -- that buy and sell healthcare services of one kind or another. But we have also -- I also use -- and used -- in the reports for this issue of markets to mean markets for individual insurance, small group, etcetera. So we use markets in a number of different ways.

Q. Can it be used in a geographical sense?

A. Yes. We do use it in a geographical sense. For example, a project that I have been working on since the mid-1990's, called Community Tracking Study, it is a project that we do for -- with a group called the Center for Studying Health System Change in Washington, that looks at how healthcare markets change over time.

The markets are defined using public government designations of markets. So, for example, the Seattle market, in that project, is King, Snohomish, and Island Counties.

Q. In general, could you describe how HPAP goes about conducting the kind of analysis that you have generally described?

A. Sure. We generally use sort of an approach of triangulation. We take information from as many

different sources as we can find, for example, of the published literature, key informant interviews. We have done surveys and tried to look at that information as it pertains to a particular issue that we are looking at or a project that we are working on, and try to understand how the different -- those different sources of information relate, are there themes, are there differences and the like.

Q. Is reliance on that kind of information you have just identified, accepted practice in your field of healthcare policy analysis?

A. Yes, it is.

Q. In addition to your responsibilities with HPAP, do you teach courses at the University of Washington?

A. Yes, I do. I teach -- I have taught a number of graduate courses in health policy.

Q. Are you a member of any professional organizations?

A. Yes. I am a member of the national and state public health associations and several others.

Q. Have you been involved with any publications in the area of healthcare policy?

A. Yes. The vast majority of my publications are policy reports and technical reports about health policy and related topics, as well as, a couple of peer-reviewed articles on the subject.

Q. I believe before you you have a binder with some exhibits in it, and I would like for you to turn to -- what I hope -- is the first one, which should be Exhibit I-52. Do you have that?
A. Yeah. Actually, the first in my book is I-51.
Q. I will come back to that.
A. Okay.
Q. Is Exhibit I-52 a current copy of your CV?
A. Yes. It is a copy that is dated April of 2004. So it is pretty current.
MR. CALIA: I would like to move for the admission of Exhibit I-52 into the record.
MR. HAMJE: No objection.
MS. EMERSON: No objection.
JUDGE FINKLE: Admitted.
Q. In connection with Premera's proposed conversion to for-profit status, could you generally describe what you have been asked to do?
A. Yes. We were asked to look at the potential effects of a Premera conversion on the states of Washington and Alaska, looking at how that conversion might affect the healthcare systems in those states, the policy holders, consumers and providers.
Q. Okay. And in connection with doing that analysis, there has been prefiled testimony served and filed in

this proceeding, which I believe is Exhibit I-51. Do you adopt that testimony?
A. I do.
MR. CALIA: I would like to move for the admission of Mr. Katz' prefiled testimony in this matter.
MS. EMERSON: No objection.
MR. HAMJE: No objection.
JUDGE FINKLE: Admitted.
Q. Also in the binder I believe you have Exhibits I-53, I-54, and I-55. Could you identify those, please?
A. Yes. In order, they are the first report that was produced by HPAP for this project. The next is the second of the two reports that were produced by HPAP, and the third is the supplemental report that I wrote.
Q. And do you adopt the opinions set forth in those three reports?
A. I do.
MR. CALIA: I would like to move for the admission of Exhibits I-53, I-54, and I-55.
MS. EMERSON: No objection.
MR. HAMJE: No objection.
JUDGE FINKLE: Admitted.
Q. Let me just ask you generally, Mr. Katz, did anybody assist you in pulling together those reports?

A. The first two reports were produced by the Health Policy Analysis Program. I led a team that included staff of HPAP, as well as another faculty person in the school, as well as an outside expert.
Q. Okay. Would it be fair to say that you supervised the creation of the two HPAP reports?
A. Yes.
Q. Mr. Katz, do you consider yourself an expert in economics or anti-trust?
A. No.
Q. Do you consider yourself an expert in tax or accounting issues?
A. No.
Q. Do you consider yourself an expert in actuarial matters?
A. No.
Q. Do you believe that the fact that you are not an expert in these particular areas affects the validity or the conclusions set forth in those three reports?
A. No.
Q. Why not?
A. Well, because this was really a policy analysis focusing on the questions about the effects of a conversion of Premera on -- as I indicated, these two states, their health systems, the consumers and

providers in those states. And that's really a question of policy issues, and we were looking at the policy issues that might arise.

Q. In turning to the first HPAP report, which is Exhibit I-53, could you generally describe the subject of that report.

A. Yes. The first report was designed to sort of discuss, establish and describe the role that Premera Blue Cross has played in the two states, now and in recent years.

Q. How did you go about conducting that analysis?

A. Most of that work was collecting of -- a collection of publicly-available data, for example, data from the office of the Insurance Commissioner's Office, as well as other publicly-available data, to help us understand the role that Premera played in the entire system, as well as certain segments of that system.

Q. Did you also conduct key informant interviews?

A. Yes. We conducted I think 19 interviews with individuals that we thought had important views about -- and knowledge about the broad areas in those two states. And those interviews were designed to supplement a much larger set of interviews that were being conducted in the North Carolina conversion case, whose summaries that we had access to.

Q. Could you briefly summarize the conclusion that you have drawn in analyzing the markets in Washington and Alaska set forth in your first HPAP report.

MS. EMERSON: I will object to any testimony on the issue of the impact of the conversion on Alaska. I believe Your Honor has already ruled that Alaska impact testimony is beyond the scope of this proceeding.

MR. CALIA: The question related to summarizing what he concluded about the state of the markets in Washington and Alaska. I have not asked the question about impact.

MS. EMERSON: Same objection.

JUDGE FINKLE: It needs to be confined to Washington.

Q. Okay. Would you please -- I will restate the question, Mr. Katz. Could you briefly summarize the conclusions that you have drawn in analyzing the markets in Washington state?

A. Sure. Premera and its predecessor, Blue Cross of Washington and Alaska, has been one of the three major health insurers in the state and continues to be. It is, according to the data we have now, the largest of the insurers. It is a particularly important provider of insurance in the individual market, and as was stated earlier this morning, it is a very important, and

probably dominant insurer, in certain parts of the state, particularly in the individual market in rural counties in eastern Washington.

It has also been, until recently, an important participant in public programs, particularly the Medicaid Healthy Options program and Basic Health and also Medicare.

Q. Why did you qualify the participation of public programs as -- until recently, Premera has been an important player in that realm?

A. Well, as I understand it, Premera has sold its business in Medicaid and Basic Health to Molina, and I understand it has also left the -- its -- it has decided to stop being the Medicare intermediary as well.

Q. When will it stop -- when will it effectively stop being the Medicaid intermediary?

A. Medicare.

Q. Medicare, excuse me.

A. I don't know the date.

Q. What, if anything, is the significance of the sale of certain portions of its healthcare products, as well as the withdrawal from the Medicare market, in your estimation?

A. Well, you know, I don't know for a fact, because I don't know the motivations of Premera, but it is

consistent with the concerns that we raised in these reports, and that I raised, that prior to the date at which conversion is approved, the health plan that has proposed conversion does begin to position itself for that event.

Q. If I can ask you to turn to page eight of your first report, toward the bottom you refer to a niche strategy regarding insurance companies' participation in various markets. Could you describe what you mean by that.

A. Sure. Health plans -- various health plans basically specialize or at least have greater focus in certain markets versus others.

So, for example, if you look at the relative dominance, let's say, of the three largest health plans in Washington state, Premera is the big player in the individual market relative to the other two, Regence and Group Health, and in the small group market. Whereas, I think Regence is the largest in the large group market.

Another example would be Molina and Community Health Plan of Washington, which focus exclusively in the Medicaid and Basic Health markets.

Q. Insofar as your conclusions set forth in the report are concerned, what is the significance of this concentration in various markets?

A. Well, I think as Mr. Larsen indicated earlier, that

having such a large role in the individual market, for example, in eastern Washington, puts those residents and policy holders in those markets at somewhat greater risk should Premera change how it behaves, change its pricing or change its relationship with the providers in those communities.

Q. Did you also look at Premera's market position with respect to employment-based programs?

A. Yes.

Q. What, if anything, did you conclude about Premera's position in those programs?

A. Well, as I indicated in our report, in the large group market, Premera is the largest insurer, and in the small group market, it is the second, that is of the top three, including Group Health and Regence.

Q. And what is the practical effect of the size of Premera in those markets?

A. I am not sure what you are getting at, I am sorry.

Q. In terms of Premera's ability to exert leverage in those markets in your review?

A. I would want to look at those -- we did to the extent that we could -- look at the role that Premera plays in the employment-based market by region. Because, as in the individual market, that role is quite different by region.

But, as I understand it, Premera is a very large player in the small group market in eastern Washington as well. And to the extent that it is, it would -- its dominance would put those communities likewise at some greater risk should the health plan change how it operates.

Q. I would like to now turn to the second HPAP report, which is Exhibit I-54. Could you generally describe the analysis that was conducted for purposes of creating that report?

A. Sure. This report really is bringing together the information that we had available to us, including literature -- both peer review literature, as well as other published reports on conversions. We looked at conversions in -- I think specifically we focused on 10 states, looked at information that was available in those states on those conversions. So we had that information.

As you asked before, we did a series of key informant interviews. We had access to the summary of interviews from the North Carolina report. We have all the data and information that was included in Report 1. And we looked and -- looked at that information and tried to find themes, where effects looked like they would be -- have a reasonable likelihood to occur.

Q. As a very fundamental matter, could you explain why non-profit versus for-profit matters?
A. Sure. I think this is a basic issue. That is, for-profit organizations have an added responsibility and that added responsibility is to generate margins for the shareholders.

And while it certainly is the case that all health plans in this marketplace are facing significant and have been facing significant financial pressures over the years, this would be an added one, and it is not an insignificant one as I understand it.

So the concern -- the significance of that is that what would a converted Premera do in order to generate those profits, where would that money -- how would that money be derived.
Q. In conducting the analysis set forth in this report, did you believe that you would be able to predict with complete accuracy every ramification of conversion by Premera?
A. No. I was never under that illusion. In my experience in this business, this is really a matter of trying to look at what is more or less likely, looking for trends, looking for themes. It is a very inexact arena.
Q. How many states were a part of the study that is

Exhibit I-54?
A. We looked at information from a number of states, and I don't remember exactly the number, it might have been 13 or something like that. We focused in on 10, and we chose those 10 because almost all of them -- I think 9 of the 10 -- they were relatively recent conversions.

The one exception to that was the conversion in California of two -- that became WellPoint, and we used that for the reason that it is one of the two national for-profit Blues plans. And we also were looking for conversions that there was some good information about.
Q. Beginning on page 14 of the second HPAP report, Exhibit 54, you begin a discussion about the potential effects of the Premera conversion and identified a series of areas of concern, the first of which is potential reduction and spending on healthcare. Could you generally describe the conclusions that you have drawn with respect to that issue.
A. Yes. Generally, we found that for-profit Blues health plans would tend to spend less on medical care as a percentage of their premiums than other plans.
Q. Is that somehow reflected -- strike that. Is that reflected in what's been referred to as the medical loss ratio?

A. Yes. That's one of the measurements that we looked at.
Q. Did you also study the national trends in terms of changes in the medical loss ratio -- or I should say differences in the medical loss ratio between for-profits and non-profits?
A. I would say that we attempted to look at differences in this indicator, that is, how much the health plan pays out for medical services. I am not sure that I would say we looked at trends, because I don't think there were that many data points.
Q. In terms of what you did find with respect to the differences between -- or trends -- or however you describe it -- in the medical loss ratio between for-profits and non-profits, what did you find?
A. We found -- we think that it is generally true that for-profit Blue Cross and Blue Shield plans spend less on healthcare than in the not-for-profit Blues plan. In fact, there was some information that suggested they spent less than other commercial insurers.
Q. Is that reflected in figure 7 on page 15 of your report?
A. Yes.
Q. The next area that you have identified as potential area of concern begins on page 18 of your report, and it

relates to access to insurance coverage.

Could you identify the concerns that you have raised with respect to access?

A. This particular area is talking about access to insurance coverage, and I want to separate that from access to healthcare. And this really has to do, in particular, with the affordability of insurance coverage, the extent to which insurance companies attempt to exclude people with higher medical risks or higher medical costs.

And this is an area that, I think, is of real concern, both for the policy holders of Premera -- that is, the possibility that their own coverage would be affected. But also, what effect changes in underwriting practices, benefit design practices and pricing would have on other health plans, and how they would react as well. So this is part of that concern.

Q. Did you also consider the possibility of reduced participation in public programs as part of that analysis?

A. Yes. We also looked at that, and this is one of the concerns that we raised in these reports, that a converted Premera might reduce its participation in those programs.

Q. On page 21 of your report there is a section devoted

to underwriting practices. Could you describe what conclusions you have drawn with respect to underwriting practices.

A. Well, there is not a lot of information -- not a lot of hard information, and what information we have we summarized here. But there was some evidence that, in preparing to convert or actually converting, the Blue Cross and Blue shield plans would attempt to exclude individuals who had higher medical costs in a variety of ways.

And there are a couple of examples, for example, in Missouri, in which after -- I guess before being acquired by WellPoint, Blue Cross there eliminated coverage for a certain association plan.

Q. In the next portion of your report there is a section devoted to benefit design practices, which you earlier identified as an area where there can be potentially some change, some differences between non-profits and for-profits.

Could you describe the conclusions that you have drawn with respect to benefit design practices.

A. Similar to underwriting practices, health plans can use benefit design to target their enrollment. And the concern that we gathered from looking at the information we had -- have -- had for this report, is that it

appears that, at least in some cases, this has happened. And this can happen in a number of ways, and the example here, out of -- I think that's Maine, is the use of very high -- the promotion of very high deductible plans.

And there is a general concern -- not -- I don't think there is a consensus, but among some people in the health policy world -- that high deductible plans are going to be very attractive to relatively healthy people, leaving relatively sick people facing higher and higher premiums in their own insurance price.

Q. You mentioned -- touching upon that, you have mentioned one of the concerns is a potential negative effect on premiums, which is discussed, beginning on page 19 of your report.

Could you summarize the conclusions that you have drawn with respect to that issue, please.

A. Yes. The concern about rising premiums, I think as I indicated earlier, is that if premiums were to rise faster than they otherwise would, that that would accelerate or increase the number of people without coverage, as premiums become unaffordable. And premiums as I think -- I guess it was Mr. Larsen talked about earlier, increasing premiums is one way to generate the margins that a publicly-held company would have to -- that's one way they would be able to generate those

margins.
Q. Now, do you understand that Premera has made certain assurances related to premiums?
A. Yes, I do.
Q. And did those assurances dissuade your concerns about the potential increase in premiums that might result from the conversion?
A. My understanding from -- I guess it is the revised Form A, if I am referring to the right document, is that Premera has made some assurances about its various pricing practices, and that they wouldn't change those for two years.

And my reaction to that is, but that's only two years. So what happens after two years? So it doesn't change my concerns. It would perhaps put them off for two years.

I would have -- an added concern is would they then increase premiums even faster after two years to make up for lost time.
Q. Based on your research of what's happened in various states, is there a -- in terms of a change in premiums, is there a clear delineation between the pre-conversion or the post-conversion world?
A. No. I don't think we were able to find that. I think it is very difficult. And in part, that's

because -- again, as I have indicated, as we discussed in these reports, and maybe Mr. Larsen discussed this earlier, I don't remember -- that in a number of ways conversion is a process. And that companies who are preparing to convert, preparing to establish their -- shore up their -- or strengthen their financial position for that event, begin to make business decisions that might otherwise be looked at as "Oh, that's the result of somebody converting already." So I think it is very hard to find the delineation between pre and post.

Q. Two other concerns identified -- or subject areas identified in your report relate to rural coverage and public programs, and this discussion begins on page 22.

Could you summarize your conclusions with respect to those two areas, please.

A. Yes. In rural coverage, you know, it is a complicated picture. And we heard differing points of view from both the people we talked to, as well as from the other information that we had from other states about whether a converted Blue Cross plan would be more or less likely to withdraw from rural markets or rural communities.

I think our concern really rests in the particular areas -- particular parts of the insurance market, particularly the individual market, and public programs

in which -- in some community, some counties, there are relatively few -- either actually available or few options that are -- that the people there, for whatever reasons, choose. And those counties would be particularly vulnerable, again, if business practices changed.

In the area of public programs, in this state, the Medicaid program, as well as the Basic Health program, have been dependent on health plan participation, health plan contracts.

In fact, in both of those programs, originally the hope was that a very large number of health plans would be participating, so that across the state there would be many options for people -- for beneficiaries of those programs. And over the years, the number of health plans participating has decreased quite a bit.

Again, Premera had been or has been a significant provider of health coverage in those programs, particularly in eastern Washington.

Q. As part of your analysis, did you also look into potential effects on quality, which I believe -- strike that.

Did you also look at potential effects on quality?

A. Yes, we did look at quality and -- to see if there

were any differences among -- between for-profit and non-profit plans or converted and non-converted plans.

Again, the picture is complicated, first and foremost, because quality is kind of a vague topic, nobody can quite decide how to -- there isn't a consensus on how to define it, much less measure it.

There is some indications in some of the literature that we looked at that quality indicators for non-profits look better than for-profits. And in some cases, on some indicators, for-profits look better.

Q. Did you also investigate the effects -- potential effects on community benefits?

A. We did look at the effects on community benefits. And just to make sure that you understand what I mean, community benefits are those benefits that would accrue to -- usually parts of the community that are not the direct recipients of the health insurance products that -- in this case, Premera -- would sell, so things like subsidizing community health promotion programs or safety net services and the like.

And you know, this is an area I think -- generally, the concern derives from the fact that historically -- particularly, in this state -- we have had a non-profit oriented healthcare system, and certainly the insurance market has been dominated by non-profit organizations

that have tended to have very strong missions.

And as a result of those missions, those organizations -- I would include hospitals and a whole variety of organizations -- have provided a variety of community benefits.

And the concern, again, would be that a converted -- Premera, which has been such a significant part of the healthcare system -- once converted would be less oriented towards providing community benefits.

Q. As part of your analysis, did you consider what might happen should a converted Premera subsequently be purchased by a national company?

A. I am sorry, could you repeat that.

Q. I will repeat the question. As part of your analysis, did you consider the potential effects of what could happen in the event that a converted Premera would be purchased by a national company?

A. Yes. We did look at that topic. And the reason is that of the, I think, 16 conversions of Blue Cross/Blue Shield plans that have happened over recent years, 13 -- either simultaneously or subsequently -- were involved in a merger or acquisition by one of the two now national Blues plans, Anthem or WellPoint. So we thought it was quite reasonable to consider the added effect of an acquisition.

Q. And what did you conclude about what the added effect might be?
A. Well, I think generally, that the concerns that we had related to conversion would be accentuated by the -- by an acquisition, loss of local control, attention by a regional or national Premera to regional or national markets, as opposed to local communities.
Q. In conducting your analysis, did you see any evidence of benefits going from the conversion that would accrue to the public, that would outweigh all of these concerns that you have identified?
A. Well, we didn't look -- I mean, we weren't really asked to look specifically at benefits. But in -- in the course of reading the material that we had, the published literature of both peer-reviewed and non-peer-reviewed literature, there is a lot of discussion about the potential benefits. And we talked about the arguments that Blues plans have made, particularly access to capital. And there wasn't, to me, a lot of opinion -- much less, hard information -- that showed that there would be substantial benefits. But that's of a very general review.
Q. If I could ask you to turn quickly to the third report, which is Exhibit I-55. Could you briefly describe the analysis set forth in that.

A. Yes. Now, this is a report in which I was asked to look at certain confidential and "attorneys' eyes only" reports that had become available that I was allowed to see. And I was asked to read those reports, and if there were any changes in my -- in the findings from the two HPAP reports, to talk about that. And that's the part of this third -- this third report.

The other part was -- in the course of reading these additional documents, I did read a report by Mr. Reid talking about the -- what I think he considered the benefits of the creation of philanthropic foundations, in this case, two foundations, and I discussed my views of that report.

Q. Turning to the second subject that you mentioned first, which is the Foundations. Would the various concerns that you raised concerning potential conversion, in your opinion, be negated by the creation of the two Foundations?

A. No. I think my views are consistent with Mr. -- I guess, Dauner's views. That, while foundations are great, and I work at a research university, and there is I think a lot of us researchers that would salivate at whatever it would be, $30 million a year, or whatever the level of giving would be.

I have worked in this field a long time, and I have

worked with foundations a long time, and I think that the benefits -- which are tangible benefits -- pale in comparison to what goes on in the healthcare marketplace.

And so I think -- I don't think the creation of a foundation or the activities or the programs or services that it would fund are a salve to whatever problems might arise.

Q. Did any of the information that you reviewed for purposes of creating the supplemental report, Exhibit I-55, alter the conclusions set forth in the prior two reports?

A. No.

Q. If I could ask you quickly to turn to Exhibit P-28, which hopefully you have before you, which is a Hall and Conover article.

A. Okay.

Q. I believe you heard this morning some testimony about that article Premera has used as an exhibit with a couple of its witnesses or identified with a couple of questions related to witnesses.

In your view, does this article detract from the conclusions you have drawn in your three reports?

A. No, it doesn't. This is a very good paper, and we used a lot of the information that these two researchers

developed, especially for the North Carolina case. They are looking at four states here, and they weighed a similar amount of -- similar kind of information, similar quality of information that we weighed. And they made a similar series of -- came to a similar series of findings, which is "Well, we didn't see any" -- "We couldn't find any measurable impacts, but there are some potential measurable impacts," and they indicate those in their conclusion, as well as elsewhere in the text.

Q. In the conclusion portion of that paper, what are some of the negative impacts that the authors have identified?

A. The conclusion is on -- at least on my version -- on page 17 of their paper. And basically they reiterate the concern about the incentives that would be enhanced or accentuated by the change to a publicly-traded company, and the need to meet this new expectation of shareholders that they didn't have before, and the concern that that might result in lower spending on medical care, higher spending on administrative costs, changes in underwriting practices.

MR. CALIA: I have no further questions at this time.

MR. HAMJE: The OIC staff has no questions.

CROSS-EXAMINATION

BY MS. EMERSON:

Q. Good morning, Mr. Katz.

A. Good morning.

Q. Now, you have testified that you examined policy issues; correct?

A. That's correct.

Q. And some of these policy issues required you to determine whether Premera has an ability to exert leverage in the marketplace; is that correct?

A. That's correct.

Q. And you have looked at Premera's market position?

A. That was one of the -- a number of factors we looked at.

Q. You looked at market concentration, market dominance; is that correct?

A. What we looked at was the role that Premera played in a variety of sectors in the healthcare system. And we attempted to quantify, using publicly-available data, how large of a role it played in these various segments.

Q. Now, you testified you are not trained as an economist; is that correct?

A. That's correct.

Q. In fact, you have only taken a single economics course in your entire academic career; isn't that right?

A. That's my memory of it.
Q. In fact, you have told me in a deposition, you only have a street-level understanding of economics; is that right?
A. If that's what I said, then I certainly testified to that.
Q. And you don't understand how an economist defines a relevant market, do you?
A. I don't presume to speak as an economist.
Q. And you are not trained, in any sense, as an actuary?
A. No.
Q. As an accountant?
A. No.
Q. As an investment banker?
A. No.
Q. You don't hold any professional licenses, do you?
A. No.
Q. And you are not an expert on Washington health insurance regulations, are you?
A. I wouldn't consider myself an expert, no.
Q. In fact, didn't you tell me that you have only a cursory understanding of the rate-setting regulations for the individual line of business in the state of Washington?

A. That's correct.
Q. Now, you have testified a little bit about your academic experience. Your undergraduate degree is in zoology?
A. That's correct.
Q. And you have also testified that you have some training in Canada, the Canadian health system; is that correct?
A. Well, I went to graduate school at the University of Toronto, that's where I got my graduate degree.
Q. And that was a one-year certificate from the University of Toronto?
A. It was a one-year program. It was a master's level program, fairly intensive for that year, yes.
Q. Now, you have testified that you were on the faculty of the University of Washington; is that correct?
A. That's correct.
Q. Now, you are -- are you a tenured faculty at the university?
A. No, I am not.
Q. And is your position a tenure-track position?
A. No.
Q. Is it correct you are a senior lecturer --
A. That's correct.
Q. -- at the University of Washington?

A. That's correct.
Q. Now, you have told us a little bit about your approach to preparing your reports, and you have talked about some key informant interviews that you conducted.
Now, it is correct that you went to your clients, the WSMA and the WSHA, to identify some of your key informants; is that correct?
A. We asked for their help in identifying some key informants, that's correct.
Q. In fact, Mr. Greenawalt of WSHA ended up being one of your key informants; is that correct?
A. That's correct.
Q. And Dr. Rodney Trytko, who is the WSMA policy director, is another one of your key informants; is that correct?
A. That's correct.
Q. Now, isn't it true that Calvin Pierson of the Maryland Hospital Association was another one of your key informants?
A. I think that's correct.
Q. Now, you have talked about some concerns that you have. Now, one of the concerns that you have identified is about premiums possibly going up as a result of the conversion.
Now, you yourself, did not attempt to determine

the extent to which Premera's premiums would increase as a result of the conversion, did you?
A. No. We were looking at information that we had available -- both in the literature, as well as later on in the reports that were produced for this issue by the Office of the Insurance Commissioner's consultants.
Q. And do you have a view as to the extent to which Premera's premiums could go to as a result of the conversion?
A. I have no view about the -- estimating of what Premera's premiums might go to. Our concern was, again, that a converted Premera would have --
Q. I am sorry, Mr. Katz. It was -- simply called for a yes or no answer, and we are under a time crunch here.
MR. CALIA: I am not sure that question did. I disagree.
JUDGE FINKLE: I agree. So you can redirect if you need to.
Q. Now, Mr. Katz, although you have some concerns about Premera's premiums, you didn't examine the competitive response by any of Premera's competitors in the event that Premera tried to raise premiums, did you?
A. No, we considered that. But we certainly didn't do any analysis of that.
Q. Now, Mr. Larsen testified that competition is an

effective restraint on rising premiums. Do you agree with Mr. Larsen?
A. Oh, yes, I do. And that raises the concerns about where else a converted Premera would be able to generate the margins that it would need to meet, to meet shareholder expectations; including, for example, changes in underwriting practices and changes in its negotiations or relationships with providers.
Q. Now, you have claimed that you have concerns about provider reimbursements could go down as a result of the conversion; is that right?
A. That is correct, that is one of our concerns.
Q. Again, you yourself, did not attempt to quantify the extent to which a provider could decrease from current levels, did you?
A. No. We were not in the position to do that.
Q. Did you review the report of Dr. Leffler on the issue of whether Premera has any present or future ability to lower provider reimbursements?
A. I believe I did.
Q. Is it your understanding that Dr. Leffler said in his report and testified again last week, in which Premera has no such present or future ability to lower reimbursements any lower than they are now?
A. To be honest, I don't remember his report, and I

certainly don't -- I haven't listened to or read his testimony, so I can't attest to what you just said. But I think there is a lot of room for maneuvering in the marketplace, by both buyers and sellers.

Q. You didn't study that though, did you, Mr. Katz?

A. I am sorry, study what?

Q. You didn't study that?

A. That, meaning --

Q. Room for maneuvering by buyers and sellers.

A. No. Again, we looked at --

Q. Thank you, Mr. Katz. My question called for a yes or no answer.

Now, Mr. Katz, you have talked a bit this morning about the incentives that a for-profit health plan would have. Now, I understand that reported today -- or, excuse me, on May the 14th in the Puget Sound Business Journal, the CEO of Swedish was quoted as saying that even though Swedish is a non-profit organization that's a bit of a misnomer. "Swedish," he said, "must operate as a business to earn the profits it needs to grow, expand and replenish facilities in technologies. It is a grow or perish profession. There is no such thing as the status quo?"

Do you disagree with Mr. Peterson's views of his non-profit purpose?

MR. CALIA: I will just object as lack of foundation. If there is a document that --

JUDGE FINKLE: Sustained. You can rephrase the question.

Q. Well, separate and apart from any document, would you disagree -- would you disagree with the characterization by Swedish's CEO of their non-profit --

JUDGE FINKLE: Sustained, that's not in evidence. You can ask about the opinion itself.

Q. Mr. Katz, do you disagree with the concept that non-profit entities must operate as a business to earn profits that it needs to grow, expand, and replenish its facilities and technologies?

A. Are you asking for a yes or no answer?

Q. Just whether you agree or disagree with that?

A. I can't answer a yes or no. Before I leap into a discussion, I want to know if that's what you are looking for.

Q. Whether you agree or disagree, Mr. Katz.

A. Every organization, certainly in the healthcare region, needs to generate excess revenues, that's the case. And if that's what the CEO at Swedish was saying, it is certainly the case.

The question really is -- well, there is two questions. One is what is done with those excess

revenues, that is, who derives benefit from those revenues. And secondly, in this case, in this issue, is what is the added pressure on publicly-held Premera to generate additional revenues to meet the expectations of the shareholders.

So it is not really a question of whether organizations have to generate --

Q. I am sorry, Mr. Katz. The question simply called for a yes or no answer.

JUDGE FINKLE: You invited a longer answer. Go ahead and complete your answer.

A. It is not a question of whether organizations need to generate excess, it is not as simple as that. In this case, it is a question of whether there is additional pressure on this organization to generate additional margins.

Q. Now, Mr. Katz, you are familiar with the journal, the Milbank Quarterly; correct?

A. I am.

Q. And you view it as reputable?

A. I do.

Q. In fact, you understand the Milbank Quarterly to be one of the major journals in health policy circles; is that correct?

A. That's correct.

Q. Now, you understand also that the articles published in that quarterly are peer reviewed?
A. That's correct.
Q. You have testified you are familiar now with the article by Professor Chris Conover of Duke and Professor Mark Hall of Wake Forest on the impact of Blue Cross conversions with respect to accessibility, affordability, and the public interest; correct?
A. I am familiar with it, yes.
Q. Now, you talked a little bit about your view of their conclusions. Tell me, Mr. Katz, do you agree or disagree with the first conclusion that they set forth, and I am reading from page 17, the same page you were referencing. "Conclusion, we did not detect any major negative health policy effects, so far, from free-standing conversions of Blue Cross plans in the states where they have occurred."
A. That's a reasonable conclusion that they derived from looking at these states. I don't agree with that conclusion as it pertains to conversions in general or the potential impacts in this case.
Q. Now, as part of your work on this proposed conversion, you spoke with four people that you have characterized as national experts; isn't that correct?
A. That's correct.

Q. And Professor Mark Hall from Wake Forest was in fact one of those national experts?
A. That's correct.
Q. Now, you also relied on the work of Professors Hall and Conover extensively in the preparation of your reports, and in particular with respect to the preparation of your Report 2, which addresses the proposed impacts of the conversion; isn't that correct?
A. We relied on their work, as well as the work of many other people, lots of information.
Q. And -- well, you relied on their work because you view Professors Hall and Conover as reputable; isn't that right?
A. We relied on a lot of different sources of information.
Q. Mr. Katz, could you please open up Exhibit I-54, which is your Report 2, and turn to the end of that, please.
A. Okay. What --
Q. Please turn to the end notes.
A. Okay.
Q. And I take it that there are -- looking at page 41 of your report, it appears that there are 117 end notes that are listed as part of your Report 2 on the proposed impact ; correct?

A. That's correct.
Q. Do you know, of these 117 end notes, how many of them refer to the work of Professors Conover and Hall?
A. I haven't counted them.
Q. Mr. Katz, I have counted them, there are 28. Does that number surprise you?
A. No, it doesn't.
Q. And by my math, that comes out to be about 25 percent of all of your end notes can be attributed to Professors Hall and Conover. Does my math seem correct to you?
A. It does. I don't know what significance it has though.

MS. EMERSON: Thank you. No further questions.

MR. HAMJE: We already indicated we had no questions.

JUDGE FINKLE: Right. I didn't know if that --

MR. CALIA: One or two quick follow-up questions.

REDIRECT EXAMINATION

BY MR. CALIA:
Q. Mr. Katz, did the Hall and Conover article, Exhibit

P-28, say anything about potential conversion in Washington state or Alaska?
A. No.
Q. It doesn't say anything about those states at all?
A. No, not that I remember.
Q. And they analyzed, I believe you said, four states; is that correct?
A. That's correct.
Q. And the most recent data they had considered was from 1997, which is seven years ago; is that right?
A. I believe that's correct.

MR. CALIA: I have no further questions.

JUDGE FINKLE: Any follow-up?

MS. EMERSON: Briefly.

RECROSS EXAMINATION

BY MS. EMERSON:
Q. Mr. Katz, the report published by the Milbank Quarterly appeared late in the year 2003, did it not?
A. I believe December of 2003. I can't remember exactly.

MS. EMERSON: Thank you, Mr. Katz.

JUDGE FINKLE: Thank you. Please step down. We will see you at 1:30.

(Lunch recess.)

JUDGE FINKLE: Ready to proceed?
MR. KELLY: One preliminary matter that we have.
JUDGE FINKLE: Okay.
MR. KELLY: With the Commissioner's permission, we arranged for an additional court reporter to be able to take down Mr. Odiorne's testimony. So that without burdening the current reporter, we could get a quick turnaround of the transcript, that's Ms. Sandra Jarchow that's seated off to the right, and she will only be taking Mr. Odiorne's testimony.
JUDGE FINKLE: Fair enough.
MS. HAMBURGER: The Intervenors call Scott Benbow.

SCOTT BENBOW, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MS. HAMBURGER:

Q. Could you please state your name for the record and tell us where you live.

A. Yes. My name is Scott Benbow, and I live in San Francisco, California.

Q. And where do you work?
A. I work at Consumers Union, in the west coast office of Consumers Union, in San Francisco.
Q. What is Consumers Union?
A. Consumers Union is a non-profit organization whose mission is to test products, inform the public, and protect the public on certain issues.
Q. Does Consumers Union also run a business?
A. It does indeed. It publishes a magazine called Consumer Reports and it also has an on-line publication called ConsumerReports.org, and has a number of other books and publications.
JUDGE FINKLE: You need to speak a little more into the mic or move the mic a bit.
THE WITNESS: Shall I repeat anything?
JUDGE FINKLE: I think you are okay. Thank you.
Q. Is Consumer Reports a commercial enterprise?
A. Yes, it is.
Q. And is Consumers Union a non-profit charitable corporation?
A. Yes, it is.
Q. Does Consumers Union have members?
A. It does have members. Its subscribers are members, subscribers to the magazine and the on-line publication.

Q. How many members does Consumers Union have in Washington state?
A. In Washington, Consumers Union has 98,048 members.
Q. What do you do at Consumers Union?
A. I am a staff attorney on the Community Health Assets Project. This is a project that Consumers Union and its partners in Boston, called Community Catalyst, work together focusing on the conversion of non-profit organizations, health organization of hospitals and insurers, to for-profit status.
Q. And how is that project funded?
A. That project is funded by grants from the Ford Foundation and by the Kellogg Foundation.
Q. I just want to direct your attention to -- in this matter, have you filed a prefiled direct and responsive testimony?
A. Yes, I have.
Q. And have you submitted a resume?
A. Yes, I have.
Q. I just want to draw your attention to -- you have a book up there of the exhibits, what's marked as Intervenors Exhibit 57.
A. Okay.
Q. Can you tell us what that is?
A. This is my current CV.

Q. Can you highlight for us your background on healthcare conversion issues?
A. Sure. I have been working for Consumers Union now for four years on healthcare conversion issues. Frankly, I had no experience before that. There aren't too many places to learn about health care conversions, except in forums like these.
Prior to working at Consumers Union on this issue, I worked in a couple of countries overseas, a country called Republic of Palau, and another country called the Federated States of Micronesia, and prior to that, a very short term project in Ethiopia.
Q. They are not working on health care conversions in Palau, are they?
A. No conversions yet in that part of the world, that I am aware of.
MS. HAMBURGER: Okay. I would like to move to admit Intervenors Exhibit 57.
MR. KELLY: No objection.
JUDGE FINKLE: Admitted.
Q. And are you here today to speak on behalf of the Consumers Union?
A. Yes, I am.
Q. Why is Consumers Union interested in the conversion of Premera Blue Cross?

A. Consumers Union is interested in the conversion proposal made by Premera at this time because it is concerned about the impact that the conversion may have on consumers in Washington.

Q. And how long has Consumers Union worked on this issue?

A. For about 10 years.

Q. When did Consumers Union start working on this issue?

A. In the 1990s some of my predecessors at Consumers Union began to notice a trend in non-profit conversions, and began to focus attention on the health impact and the charitable assets that they felt existed in the plans that were converting, and did what they could to protect consumers by trying to minimize health impacts when conversions happened and to ensure that non-profit assets are set aside.

Q. What states has Consumers Union worked on this issue?

A. We have worked in 42 states, and the District of Columbia and Puerto Rico to date.

Q. And has Consumers Union worked with consumer advocates in Washington state on healthcare conversions in the past?

A. We sure have. In 2000 and 2001 Consumers Union

worked with consumer advocates and community groups in Washington on the proposal by Regence to convert -- I am sorry, the proposal by Regence to what we thought was a merger actually, with Healthcare Service Corporation, in Illinois.

And prior to that, some predecessors of mine at Consumers Union worked on the health -- with the hospital conversion legislation in the state.

Q. Now, referring you to Intervenors Exhibit 56, your prefiled direct testimony, do you have any changes or corrections to that prefiled direct testimony?

A. I have two I would like to make. On page four, I left out a couple of words from the very top line on the page, where it says, "These assets were not and never were owned by the non-profit corporation." What I meant to say was, "These assets are not and never were owned by the directors of the non-profit corporation."

Q. Any other corrections?

A. There is another on page six. In paragraph number 15, I presumed, perhaps too quickly, that the Insurance Commissioner would be the appropriate regulator to appoint a diverse planning committee. I had not researched that. The Insurance Commissioner may be appropriate, but I also think that the attorney general might be the appropriate regulator. So I would like to

change that to read, "Recommends the appropriate regulator appoint a diverse planning committee."

Q. Other than those two changes or corrections do you adopt the testimony?

A. Yes, I do.

Q. And do you adopt it with those changes?

A. Yes, I do.

MS. HAMBURGER: I move to admit Intervenors Exhibit 56.

MR. KELLY: May I Voir Dire briefly?

JUDGE FINKLE: Yes.

VOIR DIRE EXAMINATION

BY MR. KELLY:

Q. Mr. Benbow, you were not admitted to the bar in the state of Washington?

A. That's correct.

Q. And you are also not admitted to the bar of the state of California?

A. That's correct.

MR. KELLY: I do not believe -- I guess we do not object to the admission of 56 on the condition that Mr. Benbow's testimony, as regard to certain paragraphs, which have legal conclusions, simply be treated as his observations about legal conclusions

rather than his testifying as a lawyer about them. Those are paragraphs 7, 12, 13 and 14 in the direct, and 3, 8 and 9 in the rebuttal.

MS. HAMBURGER: Your Honor, first of all, this objection is certainly not timely, as objections related to the prefiled testimony were heard several weeks ago and dealt with at that time.

Second, Mr. Benbow has testified he is here to represent Consumers Union's position, and that's what his testimony is about.

MR. KELLY: I only looked it up last night on Calbar to see if he is a lawyer or not. But I don't think that's the point. The point is he is not a lawyer, and he shouldn't be permitted to give legal opinions.

JUDGE FINKLE: I think he is a lawyer, just not admitted --

MR. KELLY: Not admitted in California, which is what these legal opinions pertain to.

JUDGE FINKLE: Since there hadn't been an issue raised before, I haven't reviewed the paragraphs you talked about, I will limit the use of these paragraphs and of the prefiled direct and responsive to personal opinion, not a legal opinion in Washington, which must come from other sources, unless there is a

further foundation laid during this testimony that relates to basis of the opinion --

MS. HAMBURGER: Mr. Benbow's testimony is about Consumers Union's position on these matters.

THE COURT: As long as it is understood it is Consumers Union's opinion and not an expert legal opinion about Washington law and we will forge ahead.

MS. HAMBURGER: Thank you. So I am sorry, is the exhibit admitted.

JUDGE FINKLE: The exhibit is admitted, yes. That was 56.

MS. HAMBURGER: All right.

DIRECT EXAMINATION (Continued)

BY MS. HAMBURGER:

Q. And your prefiled responsive testimony is at 62, as Intervenors Exhibit 62. Do you have any changes or corrections to that?

A. No, I do not.

Q. Would you adopt that testimony?

A. Yes, I do.

MS. HAMBURGER: I would move to admit Intervenors 62.

MR. KELLY: No objection, except as previously stated, particularly, in regard to paragraphs

3 and 9.

JUDGE FINKLE: Admitted, same limitations.

Q. Can you identify what's marked as Intervenors Exhibit 58?

A. Yes. Exhibit 58 is a publication called Building Strong Foundations, which is published by Consumers Union and Community Catalyst, our partner in Boston, which is sort of a blueprint for building foundations post-conversion.

Q. And can you identify what's been marked as Intervenors Exhibit 59? Before you respond to that, I want to note that I had -- the original submission had been incomplete, and about a couple of days ago last week I provided all the parties with a complete copy of the Intervenor Exhibit 59.

MR. KELLY: No objection.

MS. DeLEON: None.

JUDGE FINKLE: Admitted.

A. Exhibit 59 is a publication entitled -- it is a long title, "Conversion and Preservation of Charitable Assets of Blue Cross and Blue Shield Plans: How States Have Protected or Failed to Protect the Public Interest."

This is another joint publication of Consumers Union and Community Catalyst, which Consumers Union submits to the Insurance Commissioner to try to tell the story in

various other states that have encountered conversion issues.

Q. Can you identify Intervenors Exhibit 60?

A. Yes. This is a publication by a non-profit organization in Washington, DC, called Grantmakers in Health. It is entitled, "A Profile of New Health Foundations," and it is essentially an annual survey that Grantmakers in Health does of new health conversions and foundations.

Q. Intervenors Exhibit 61?

A. Exhibit 61 is a prior year survey by Grantmakers in Health, with a different title, but it is the same project.

Q. And Intervenors Exhibit 63?

A. This is the article from the Chronicle of Philanthropy. This tells the story of the Blue Cross of California conversion.

MS. HAMBURGER: I would like to move to admit Intervenors Exhibits 57, 58, 59, 60, 61 and 63.

MR. KELLY: No objection.

MS. DeLEON: No objection.

JUDGE FINKLE: Admitted.

Q. Does Consumers Union have concerns about the health impact of conversions?

A. It does have concerns about the health impact of

conversions. We are agnostic on whether or not health insurers should convert. But if a proposal is made, Consumers Union believes that the regulators, in a given state, should look at what negative health impacts or positive health impacts may spring from a conversion. If there are negative impacts, it should weigh those very carefully before allowing a conversion to go forward.

Q. What has Consumers Union done regarding the health impact of the proposed Premera conversion?

A. In 2003, Consumers Union provided a grant to the Premera Watch Coalition and the Alaska Intervenors to hire HPAP to conduct a health impact study.

Q. Have you read the report by HPAP and by Aaron Katz?

A. Yes, I have.

Q. And what is Consumers Union's position on the issues and concerns identified in those reports?

A. Mr. Katz points out that -- several things that are of concern to us. One of them is that the health impact may be negative from this particular conversion. He points out that premiums may rise, that the overall spending on health may drop, and that administrative costs may rise as a result of this.

Because we are a consumer rights organization, we are also very concerned about consumer and customer

satisfaction. And the parts of his report that could speak to that are things that we are concerned about too.

Q. Does Consumers Union think that there is a difference in consumers' experience in non-profit health insurers versus for-profit health insurers?

A. Mr. Katz talked about the various missions of non-profit and for-profit health carriers. The for-profit being designed to maximize profits for investors, and non-profit health organizations having a mission to serve other purposes, serve the purposes of the needy and the underserved and uninsured.

Q. Has that been the experience of Consumers Union in its relationship, from what it hears from its members?

A. Consumer Reports Magazine has published a couple of articles in the past from surveys of readers on non-profit and for-profit health insurers. And those are -- the two articles that I am aware of in 1999 and 2003, readers reported that they were happier with the non-profit plans than for-profit. Let me restate that.

The plans that came out on top, on customer service or customer satisfaction were non-profit plans. There were some for-profit interspersed in the 2003 report on PPOs and HMOs, but most of the top 15 were non-profits.

By the way, I should say that's not a report that I

did. That was something that the magazine did. It is what I understand to be the readers' survey.
Q. Is Consumers Union concerned about executive compensation issues in conversion?
A. Yes, we are. Insofar as the issue of executive compensation may be driving a conversion, we are very concerned. It is something that we have written about in the past and something that we urge regulators to consider.
Q. Has Consumers Union done a report on this issue?
A. Yes, it has.
Q. Can you turn to what's been marked as Intervenors Exhibit 75?
A. This is a publication entitled, "How Much is Too Much?" And this is by a colleague of mine in our New York office on executive compensation.
MS. HAMBURGER: We move to admit Intervenors Exhibit 75.
MR. KELLY: No objection.
MS. DeLEON: No objection.
JUDGE FINKLE: Admitted.
Q. Does Consumers Union have a position about whether this conversion should occur?
A. Consumers Union urges the regulator to be careful -- the Insurance Commissioner to be careful in weighing the

alternatives in this case. And under the current version of the Form A filing, Consumers Union recommends that this not -- this conversion not be allowed to go forward without conditions.

Q. But does Consumers Union have concerns about the proposed foundations?

A. Yes. In particular -- and this is what I have been focusing on at Consumers Union for the past several years is the foundation aspects of conversions.

There are several things that concern Consumers Union about the Foundation shareholder in Washington as it's set up now.

Q. What are some of those concerns?

A. We are concerned that, as a 501(c)(4), the Foundation shareholder is not required under the bylaws or under the transfer grant and loan agreement to make annual payout.

And if the conversion is accepted, and if this form of foundation is agreed upon in Washington, we would recommend that 501(c)(3) restrictions on annual payout be added to the other 501(c)(3) restrictions that Premera has already included in its 501(c)(4) documents.

Q. When you say restrictions on annual payment, are you referring to the five percent minimum annual grantmaking requirement?

A. Yes, I am. Yeah. And I call it a restriction, I guess it may be more readily be called an obligation of Premera.
Q. Are there other (c)(3) obligations that you think are appropriate?
A. There are. In the current Articles of Incorporation of the Washington Foundation shareholder, there is I think somewhat vague language about what the reporting requirements would be for the Foundation shareholder. And we would recommend that those be strengthened to be closer to a 501(c)(3), if not identical to 501(c)(3) requirements on that.
Q. Based on the Consumers Union work on conversions, how does the Foundation's tax status affect the public perception of the accountability of the conversion foundation?
MR. KELLY: I will object. No foundation as to any tax expertise here.
JUDGE FINKLE: Sustained.
Q. Does Consumers Union have a position on what the accountability of the conversion foundation should be?
A. Consumers Union believes that a 501(c)(3) foundation is better -- a private foundation organized under 501(c)(3) of the IRS code is a more publicly accountable way to go.

Q. And why is that?
A. Partially because of the payout requirements that a 501(c)(3) has, and also 501(c)(4)s are allowed to lobby.
Q. And has Consumers Union supported the creation of a conversion foundation as a (c)(4) in the past?
A. Yes, it has.
Q. And have there been certain conditions imposed in those cases?
A. Yes. In California, in the California matter, a 501(c)(4) foundation was created with 501(c)(3) restrictions.
Q. Are there other concerns that CU has regarding the proposed foundations?
A. Under the transfer grant and loan agreement there is language that prohibits the Foundation shareholder from making grants that Premera -- the new Premera would find materially adverse to health insurers. And I believe -- and Consumers Union believes -- this would have a chilling effect on the grant making of the new foundation. It would, we believe, hamper the Foundation in its efforts to make grants and make grant recipients very careful in what they were doing.

I think that because the term materially adverse is not defined in the Articles of Incorporation or in the Transfer Grant Loan Agreement, that it is too wide open,

and I think that should be narrowed.
Q. Have any Blue Cross and Blue Shield conversions in the past contained language like this?
A. Not that I am aware of.
Q. Do you have any other concerns related to the restrictions?
A. The same language, the materially adverse language, is used to restrict lobbying with the grant -- I believe grant recipients can do with grant moneys. So I would -- I believe that that is too vague and too broad too, something I think should be changed.
Q. Any other concerns along those lines?
A. One of the concerns that we have, one of the things we recommend in building strong foundations is, when you are creating a foundation, to make it as public a process as possible, and bring in as many potential stakeholders and representatives of folks who are affected and served by grants to the community, that many of those people sit on the planning committee for a new Foundation.

I know that Premera has gone a long way in creating the articles and bylaws of the Washington Foundation shareholder, but perhaps at this point there is a way to inject more public participation into the process.
Q. I am going to ask you some more questions about that

in a minute, but just going back to the materially adverse issue. Does Consumers Union have concerns about Premera's ability to sue the Foundation grantees?
A. Yes, we do.
Q. Can you describe those concerns?
A. Yes, we do. I guess when I mentioned the chilling effect before, I was thinking, but not saying, the ability of new Premera to sue the Foundation, especially the grant recipients, would really make it hard for them to do their work sometimes.
Q. Why would that have a chilling effect?
A. Some of the grant recipients of a Foundation, in this state and in other states, would probably be very small. And the threat of a lawsuit might prevent them from engaging in any activity that would even look possibly adverse to health insurers, so that they wouldn't add that materially adverse clause.
Q. So even if they are doing an appropriate activity, it would be problematic?
MR. KELLY: I will object. The witness is being led.
JUDGE FINKLE: Sustained.
Q. Let's go back now to your questions about the -- your concerns about the planning process. What kind of process should be undertaken to identify the board of

the new Foundations?
A. We would recommend that the process be opened up to people in the state of Washington -- everybody in the state of Washington, who is interested in participating, and that a planning committee be brought together -- or a board selection committee be brought together to find as diverse a board as possible for this Foundation.
The board shouldn't be composed, in our opinion, of just folks who are representatives of the uninsured and the underserved in the state, but could also have individuals who are experts in foundations already, lawyers, accountants, finance people, who may be able to guide the Foundation.
Q. Have you reviewed the testimony of Ms. Dingfield and her description of the process done by Premera, that involved 20 groups chosen by Premera?
A. Yes, I have.
Q. And should that 20-member group automatically be the advisory committee for the new Foundation?
A. I think that it would be better to open it up and have more groups be part of an advisory group to the Foundation.
Q. Should those groups be preferred?
A. They should not be preferred, in my opinion.
Q. And should members of hospitals, hospital

associations and medical associations, be excluded from this process?
A. No, they should not.
Q. Why not?
A. They are people with expertise in health issues, and perhaps some of them could be very helpful in this process.
Q. We have heard a lot of testimony about whether a non-profit -- whether the public owns a non-profit Blue plan. Does the Consumers Union have a position on that issue?
MR. KELLY: I will object. It calls for a legal conclusion by either this witness or his organization.
JUDGE FINKLE: Sustained.
Q. In past conversions, what is Consumers Union -- well, in the California conversion, what was Consumers Union's position regarding the public ownership of Blue Cross of California?
MR. KELLY: This is calling for a legal opinion, and it is also not relevant to this lawsuit.
JUDGE FINKLE: Why is it relevant -- what its position was in California on that issue?
MS. HAMBURGER: Well, he has offered his testimony in rebuttal to Mr. Reid, who has said that

this issue is a distraction. And yet Mr. Reid testified at great length about the Blue Cross of California conversion and issues related to public ownership of the Blue Cross of California conversion.

JUDGE FINKLE: Overruled. You may answer.

A. If you define the public as the people and not the government of California, we were very much in support of the process that occurred in California. Commissioner of Corporations Mendoza used the word public, I believe, to mean the people of the state, and those foundations were set up as -- private foundations were set up.

Q. Based on Consumers Union and your experience in working on conversion transactions, do companies often argue that they have no obligation to transfer their non-profit assets?

MR. KELLY: Objection, leading.

JUDGE FINKLE: Overruled.

A. Yes, they do.

Q. And what is Consumers' response when you hear that?

A. Looking at the histories that we have seen, often there is a non-profit obligation -- non-profit asset obligation that non-profits have under non-profit law and supre obligations.

And so we argue that those non-profit assets should

remain in the non-profit sector because of sometimes common laws, sometimes statutes in a particular state.

MR. KELLY: Object, and move to strike the latter part of the answer, it is a legal opinion.

JUDGE FINKLE: I don't think it is of much relevance, but that's the argument that's been made. So overruled. Go ahead.

Q. And does Consumers Union frequently discuss -- what does -- when -- do you get calls from regulators sometimes about conversion issues?

A. Occasionally, we do get calls from regulators about conversion issues, And the publications that we publish are made available to regulators if they are interested in reading them.

Q. Do regulators -- strike that.

MS. HAMBURGER: I am done with my questions. Thank you.

JUDGE FINKLE: Anything from --

MS. DeLEON: We have no questions.

MR. KELLY: Okay.

CROSS-EXAMINATION

BY MR. KELLY:

Q. Mr. Benbow, Consumers Union -- Consumers Union, I take it, prides itself on looking at the actual facts

and circumstances of a product or a situation and making its decisions based upon what those facts and circumstances actually are; isn't that true?
A. Yes.
Q. Okay. So I take it that, neither you nor Consumers Union, are categorically opposed to conversions?
A. That's correct.
Q. And you would agree with me it will depend upon the applicable law and the specific facts and circumstances as to whether a conversion is in the best interest of consumers?
A. Could you repeat that.
Q. Yes. Would you agree with me that it would depend upon the applicable law of the state and the facts and circumstances of the conversion to determine whether a conversion is in the best interest of consumers?
A. Yes.
Q. Okay. In this case, I think you said that Consumers Union was agnostic on this conversion --
A. No, on conversions generally.
Q. On conversions in general? Okay. Then you gave a grant to -- to have someone develop a report; is that correct?
A. That's correct.
Q. And we heard the testimony from Mr. Katz about his

report today?
A. Yeah. Actually, if I could back up just to explain that. We gave a grant to the Coalition and to the Alaska Intervenors -- the Premera Watch Coalition and the Blue Alaska Intervenors, and then that grant was used to fund the report.
Q. And in regard to that report, by the way, Mr. Katz' reports do not address Premera's customer satisfaction?
A. Uh-huh.
Q. I am sorry?
A. Yes.
Q. Yes, they don't?
A. Yeah.
Q. Probably my fault for my question. Is it true, and you can just say "that's true" if that would help, is it true that Mr. Katz' report does not address Premera's customer satisfaction?
A. I believe it is true.
Q. Okay. And is it also true that Mr. Katz did not talk to anyone at Premera or review any Premera documents in regard to customer satisfaction?
MS. HAMBURGER: Objection. This witness has no knowledge of those issues of who Mr. Katz talked to or not.
JUDGE FINKLE: Well, he may or may not. So

answer it, if you know.
A. Yeah. I am not -- I don't know the answer to that.
Q. Now, then you went on to talk for a few minutes about the Foundation shareholder and its structure as a 501(c)(4). And do I understand you correctly that you disagree with the recommendations of the state's consultants that this should be a 501(c)(4) corporation?
A. No.
Q. You just want to try and make the 501(c)(4) look like the 501(c)(3)?
A. Exactly. Yeah.
Q. Is that what you are saying?
A. Yeah.
Q. And you have no idea as to whether that can be done legally or not, do you?
A. Are you asking me to render a legal opinion?
Q. Not at all.
A. I have been instructed not to.
Q. That's fair enough. That's fair enough. Do I also understand you that you are concerned that, as a 501(c)(4), this -- the Foundations might be allowed to lobby?
A. We are concerned -- we are concerned about the -- we are concerned about -- we don't oppose lobbying. But we are concerned that the lobbying is unrestricted as it

exists now.
Q. So you want to have restrictions on what lobbying can be done by the Foundations; is that correct?
A. Let me strike that. I don't oppose the ability of a 501(c)(4) to lobby.
Q. Okay. So you want to strike your whole testimony on that?
A. Well, could you repeat the question, please?
Q. Is it your position that you don't want the Foundation to be able to lobby?
A. We recommend, in building strong foundations, that -- one of the restrictions on a 501(c)(4) that we would like to see is the 501(c)(3) restriction against lobbying. So the answer is yes.
Q. Okay. I just have got two more areas quickly. One is on the -- you touched briefly on Mr. Mendoza's activities when he was the Insurance Commissioner, I believe, down in California.
A. Actually, the corporation's counsel.
Q. The corporation's counsel, okay. And you go through this in some detail in your rebuttal testimony, do you not?
A. Yes, I do.
Q. And, of course, you are operating, I guess, on either hearsay or things you might have read in the

newspaper, since during the years in question -- let's just say it was 1994 and 1995, your resume indicates that -- it looks like you were in Micronesia and/or Ethiopia or Palau; is that true?

MS. HAMBURGER: Objection, argumentative.

JUDGE FINKLE: Try it again.

Q. During the time period that whenever Mr. Mendoza was doing in California he was doing, you were in either Ethiopia, Micronesia or Palau; isn't that true?

MS. HAMBURGER: Objection, argumentative.

JUDGE FINKLE: Overruled.

A. Yes, I was in those countries during those years. I was not working in Consumers Union at that time.

Q. I understand. But you weren't there in California close to the action, such as Mr. Reid was; isn't that true?

A. That's true.

Q. And as a matter of fact, without belaboring the point, Mr. Mendoza made demand for additional moneys to go to a foundation before the Blue Association had either authorized Blues to convert to for-profit, and well before the conversion actually occurred in California; isn't that true?

A. I believe that's true.

Q. Okay. Then, without asking for a legal opinion but

just for your opinion as a person in California, are you aware that Blue Cross of California was a public benefit corporation?

A. Yes.

Q. And are you aware, just as an individual in California, that a public benefit corporation is impressed with a charitable trust?

A. That is what I understand -- I understand that's a part of the situation in California.

Q. Very good. And then the large bulk of your prefiled direct testimony and many of these attachments deals with thoughts that you have about how one could work to help set up the more inclusive and functional and well-planned foundation; is that fair to say?

A. Yes. And also one that is more publicly accountable and that operates free of certain political entanglements and things like that, talking about a diverse board of board members who are not your traditional board members sometimes.

Q. But I think you also said the traditional folks can bring some skills that are valuable?

A. Yeah.

Q. And your understanding is that the attorney general is going to be going about the process of selecting those board members; isn't that true?

A. In the Washington Foundation --
Q. In the Washington Foundation?
A. Yes, I believe that's true.
Q. And hopefully she will read the materials that you have and take your observations to heart?
A. That's what they would like.
Q. Great. Now, one final area, you did say you were present for -- or you heard or read Ms. Dingfield's testimony, did you not?
A. Yes, I did.
Q. Ms. Dingfield made it repeatedly clear, did she not, that this ad hoc group was not reporting to be all knowing or reporting to be the exclusive body; is that true?
A. I don't remember, but I -- I don't remember that.
Q. But if she were to say that --
A. Uh-huh.
Q. -- and that she were to urge the attorney general to look across the board or to all range of people who might be interested in this Foundation, you would agree with Ms. Dingfield, wouldn't you?
A. Yes.
MR. KELLY: Excuse me. That's all I have. Thank you.
MS. HAMBURGER: I just have a couple

questions.

REDIRECT EXAMINATION

BY MS. HAMBURGER:

Q. Mr. Kelly asked you whether you can have a (c)(4) that looks like a (c)(3). Do you have any examples of (c)(4) foundations as a result of the conversion that have (c)(3) restrictions?

A. The California Endowment, I believe, and the California Healthcare Foundation -- actually, it is California Healthcare Foundation.

Q. And when Mr. Kelly asked you about lobbying -- your concerns about lobbying, your -- what were your concerns about lobbying related to the materially adverse restrictions?

A. With regard to the materially adverse restrictions, our concern -- our concern was that if the (c)(4) -- if the grant recipients are permitted to lobby, but they do something that does -- that new Premera does find materially adverse, that would be a problem.

Q. And would that also be a problem for the Foundation as well?

A. Yes, it would be.

MS. HAMBURGER: No other questions.

MS. DeLEON: No questions.

MR. KELLY: I have nothing further.

EXAMINATION

BY COMMISSIONER KREIDLER:

Q. Mr. Benbow, I am just curious, given your experience in California and the fair amount of discussions taking place relative to conversions that took place in California, does -- do you have knowledge of if there is a position by Consumers Union relative to -- so to speak unringing the bell of conversion in California, or is it one that is accepted in California?

A. I am sorry, what do you mean by unringing the bell?

Q. Meaning, a conversion didn't take place.

A. Looking back, like whether or not that conversion should have happened?

Q. Exactly. If you could go back in time, knowing what you know now, would you have supported conversion as Consumers Union knowing there was going to be a Foundation created, knowing that -- how it changed the market or how the market has evolved, would Consumers Union support or oppose conversion in California?

A. That's a really hard question, and the bell has been ringing for a long time. I actually don't have a position on that.

COMMISSIONER KREIDLER: Thank you, very much. Nothing further.

JUDGE FINKLE: Any follow-up?

MR. KELLY: None.
JUDGE FINKLE: Thank you. Please step down.
MS. HAMBURGER: We would like to call Shawn Cantrell next.

SHAWN CANTRELL, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MS. HAMBURGER:

Q. Hi, Mr. Cantrell. Can you state your name and where you live for the record?

A. My name is Shawn Cantrell. I live in Seattle, Washington.

Q. Where do you work?

A. I work as the Executive Director for Washington Citizen Action.

Q. What is Washington Citizen Action?

A. Washington Citizen Action is a consumer-based organization that has approximately 50,000 members in the state of Washington working on social and economic justice issues.

Q. And how long have you worked there?

A. I have been there for slightly more than four

months.
Q. Who is your predecessor there?
A. Barbara Flye.
Q. Have you submitted prefiled testimony in connection with this?
A. Yes, I have.
Q. And that's marked as Exhibit 70. Do you have any changes or corrections to that?
A. No.
MS. HAMBURGER: I would like to move to admit Exhibit 70.
MR. KELLY: No objection.
MS. DeLEON: No objection.
JUDGE FINKLE: Admitted.
Q. And then Intervenors Exhibit 71, can you tell us what that is?
A. I am not sure. I don't know if I have that one in front of me.
JUDGE FINKLE: It is his resume.
MS. HAMBURGER: May I -- do you have it?
THE WITNESS: I don't have that one with me.
MS. HAMBURGER: May I approach?
THE WITNESS: Yes, I do recognize this.
Q. What is it?
A. It looks like my resume.

MS. HAMBURGER: Intervenors move to admit Exhibit 70.

JUDGE FINKLE: I think it is 71.

MS. HAMBURGER: Sorry, 71.

MR. KELLY: No objection.

JUDGE FINKLE: It is admitted.

Q. What is Citizen Action's interest in Premera's conversion?

A. We have a long-standing organizational involvement in healthcare-related issues in the state of Washington. And the potential conversion of Premera, when it was first announced, was something our organization was very interested in, in we thought it could have a significant impact on healthcare access and quality for citizens here in Washington, both current enrollees, potential future enrollees, as well as other citizens in the state.

Q. You are here testifying in behalf of Citizen Action's position on this issue?

A. Yes.

Q. And when was that position developed?

A. It has been developed over a long period of time. We first -- when the announcement that Premera was looking to convert, we began investigating and exploring the potential impacts, whether they be positive or

negative, consulted with members, with our board, with colleagues and allies and other organizations to try to determine whether or not we thought this was in the public interest, and whether or not it was something we should advocate for or we should raise concerns about.

This began in 2002, led to our board -- the board of directors for Washington Citizen Action formally voting at a later point after several months of discussion and investigation to oppose the conversion as originally filed.

Q. What is the Premera Watch Coalition?

A. The Premera Watch Coalition is an organization, a loose -- a federation or a coalition of I believe at least 11 different organizations -- Children's Alliance, Washington Citizen Action, Citizens Employees Union, State Counsel, the Washington Association of Churches, the Washington State Association of Community and Labyrinth Health Centers, the Washington Academy of Family Physicians, the Washington Nurses Association and many other organizations that have come together around concerns for the potential impacts of this conversion.

Q. Who can join the coalition?

A. Anybody who is willing to support the principles that the coalition as a whole develop. And each organization that is a member has to formally agree to

the set of principles that we adopted.
Q. When were those principles adopted?
A. They were adopted in -- my understanding -- I was not on the staff of WCA at the time, and hence not a member of this coalition, but I believe it was approximately September of 2002.
Q. Do you have up there the Statement of Principles, which has been marked as Intervenors 72?
A. Yes, I do.
Q. Okay. And do they express the coalition's general position on the conversion?
A. Yes, they do.
MS. HAMBURGER: I would like to enter Exhibit 72 into the record.
MR. KELLY: I have no objection.
MS. DeLEON: No objection.
THE COURT: Admitted.
Q. What has the coalition done to educate itself, its members, and the public about the Premera conversion?
A. Again, over the course of many months, and now years, we have reviewed the variety of the public documents -- both the filings by Premera, by the independent experts, consultants, other academic research, and public press releases and other information in the public realm, regarding this

conversion, to determine whether or not we thought it was in the public interest.
Q. Has the coalition issued reports on the proposed conversion?
A. Yes, we have.
Q. And do you recognize Exhibit 73?
A. Yes, I do.
Q. What --
A. This is our "Conversions: Bad Medicine" and the report that was prepared by the Premera Watch Coalition with our staff as a lead on that.
Q. And how about Exhibit 74?
A. Again, this is a report that Washington Citizen Action produced and released jointly with the other members, the Premera Watch Coalition.
MS. HAMBURGER: I would like to move to enter Exhibits 73 and 74.
MR. KELLY: No objection.
MS. DeLEON: No objection.
JUDGE FINKLE: Admitted.
Q. So what are the Coalition's general concerns about the conversion today?
A. Well, again, as we developed our principles as to whether or not a conversion would be in the best interest of the consumers and the citizens of Washington

state, we laid out a number of criteria to judge them by. And based upon our evaluation of the proposed conversion, we feel that the original proposal, as well as the revised schedule A -- or Form A or whatever it is called -- is not in the public interest.

Specifically, we feel that the conversion could lead to, as we have heard other testimony before me, to higher premiums than would otherwise be the case for enrollees at Premera, could see a reduction in benefits provided to enrollees, we could see a reduction in the reimbursements for medical providers. There is a wide range of services and expenses that we think could happen that would be detrimental.

There is also other issues as it relates to the executive compensation for Premera executives. There is concerns that we have as it relates to the Foundation on a number of different levels as well.

Q. Okay. Let's talk a minute about the potential for increases in premium rates. Do the assurances -- the two-year assurances offered by Premera address the Coalition's concerns about premium rate?

A. No. We feel that they -- the assurances are, just as you said, for only two years. And that the original position that we adopted felt -- we needed a much longer time frame to be able to judge how the impact made if

that took place, and that, as was testified earlier today by previous witnesses, that the two years, once that two years is up that we could see a dramatic increase in premiums.

Q. What are the Coalition's concerns related to the Foundations?

A. We have multiple concerns about the Foundation. Again, some of these have already been mentioned, so I won't go into a lot of detail.

But the concerns are with regards to the independence of the Foundation, whether or not -- the restrictions placed upon it or who could be served on the Foundation board seemed inappropriate. Some of their restrictions, for instance, that potential for having members of the medical association or the hospital association being prevented from serving on the board for the new Foundation doesn't seem to have any logical sense, other than potentially retribution for opposing the conversion in the first place.

We are concerned about whether or not the Foundation would in fact get full fair value for the non-profit assets that are being converted, whether or not the stock offering would in fact provide a full value for those assets.

We are concerned, as was previously testified, about

some of the lack of restrictions on the activities that a 501(c)(4) foundation may have, as opposed to some of the restrictions that we think would be more appropriate on the (c)(3), making sure they are actually giving grants, etcetera.

Q. What does the coalition think the Insurance Commissioner should do about the conversion?

A. We would ask the Commissioner oppose and reject the conversion at this time.

MS. HAMBURGER: Thank you.

MS. DeLEON: We have no questions.

CROSS-EXAMINATION

BY MR. KELLY:

Q. Mr. Cantrell, my name is Tom Kelly, I just had a few questions for you. You had a discussion in your prefiled about the sale of Premera's Medicaid program, Healthy Options, do you recall that?

A. Yes, I do.

Q. And actually what is going on there is a transfer of the business to Molina?

A. Uh-huh.

Q. You should answer yes or no for our record.

A. Yes.

Q. And Molina specializes in that type of coverage,

does it not?
A. That's my understanding.
Q. Now, let's turn to the balance of your testimony, just a few questions. Is the Premera Watch Coalition categorically opposed to all conversions?
A. No. Each one should be examined on its own merits.
Q. Very good. Would the coalition be opposed to the Premera conversion, even if it was not harmful to Premera's subscribers?
A. Potential -- it would depend upon if that was the only criteria, but that's not our only criteria.
Q. It is not your only criteria, but it is one of the criteria that the Commissioner has under the law?
A. Yes.
Q. So if it was found not to be harmful to Premera's subscribers, at least on that ground, the Premera Watch Coalition would say that the Commissioner would be right to go along with the conversion; is that true?
A. I don't know that I agree with the premise of your question. Can you repeat it one more time?
Q. I will try. One of the criteria that the Commissioner has to look at under the law is whether or not the conversion would be harmful -- I am paraphrasing -- to Premera's subscribers? If you assume that is true, as one of the criteria, and if it is

determined that this conversion will not be harmful to the subscribers, I take it the Premera Watch Coalition would not oppose the conversion on that ground?
A. I agree with the assumption that it -- that it showed not to be harmful.
Q. Right.
A. On that one level, yes.
Q. And to find out all of that, we have to look at -- or the Commissioner has to look at all the law and the facts and circumstances that have been presented to him; correct?
A. That's my understanding.
Q. Now, let me ask the other part of the criteria for the Commissioner, whether the coalition would be opposed to the conversion, even if it was not likely to be harmful to the insurance-buying public, what's your position on that?
A. Could you repeat the question?
Q. Sure. One of the criteria to be considered is whether the conversion would be likely to be harmful to the insurance-buying public. If the law and the facts and circumstances demonstrate that it would not be harmful to the insurance-buying public, I take it then the Premera Watch Coalition would say, well, that's why I move to oppose it on that ground?

A. On that ground, yes.
Q. Okay. And you recognize that, while you may have personal viewpoints, or your group may, about how things ought to be, those personal viewpoints are not criteria necessarily that the Commissioner could decide under the law whether or not the conversion can be allowed or not; is that true?
A. The criteria that we have stated are not personal opinions.
Q. Okay. They are criteria that you have developed as a coalition?
A. Yes. Based upon our understanding of the laws.
Q. Okay. Well, if it is demonstrated that those criteria are not supported by the requirements of the law, but rather just Premera Watch Coalition's criteria, you would understand those are not a basis upon which the Commissioner can make a decision in this case, would you?
A. Our understanding is that the criteria that the Commissioner has a responsibility to follow include a variety of factors, one of which may be the one they refer to, but also one that is in the public interest as well.
Q. That's your position?
A. Yes.

MR. KELLY: Fair enough. I have nothing further. Thank you.

MS. HAMBURGER: I have no more questions.

MS. DeLEON: Nothing.

JUDGE FINKLE: Thank you. Please step down. Any further witnesses?

MS. HAMBURGER: We have no more witnesses.

JUDGE FINKLE: I think we are ready for Mr. Odiorne, but why don't we take a break first and then we won't be interrupted.

(Afternoon recess.)

JUDGE FINKLE: Ready to proceed?

MR. HAMJE: We are, Your Honor. It is now I believe -- I think since I understand your ruling, after the second or third time, I believe this is the time now to reserve for Mr. Odiorne to take the stand. Therefore, the staff calls Mr. Jim Odiorne.

JAMES ODIORNE, having been first duly sworn by the Judge, testified as follows:

DIRECT EXAMINATION

BY MR. HAMJE:

Q. Please state your name.

A. James T. Odiorne.
Q. Please state your position and your employer.
A. I am Deputy Insurance Commissioner for company supervision in the Office of -- the Washington Office of the Insurance Commissioner.
Q. Please describe your educational background.
A. I have a BBA in accounting from the University of Texas at Austin, and a JD from Baylor University.
Q. Do you hold any licenses?
A. I am licensed as a CPA and an attorney in Washington and Texas.
Q. Do you belong to any professional organizations?
A. I am a member of the Washington Society of CPAs, the National Association of Managed Care Regulators, and the International Association of Insurance Receivers.
Q. Please describe your experience.
A. After graduating from the University of Texas, I served as an Assistant State Auditor for approximately four years. I was in the private practice of accounting and law for approximately nine.

In 1983, I joined the Texas Department of Insurance, stayed until 1989, and at the point I left I was serving as both liquidator and as Senior Deputy Commissioner for a financial program. In '89 I joined the Washington Office of the Insurance Commissioner, where I currently

am.
Q. How long have you been in your current position?
A. Since late '96.
Q. What are your responsibilities in your current position?
A. I am charged with managing the Company Supervision Division, and that division is responsible for licensing of insurance companies, holding company issues, financial analysis, financial examination, market conduct examination, coordination with the guarantee associations, and the management of companies that are placed in rehabilitation or liquidation.
Q. What is your role in connection with Premera's application?
A. I was designated as the coordinator for the project to examine this transaction.
Q. Can you describe your involvement in this process?
A. I was responsible for the selection process to find the consultant to work for us, which was responsible for instructions to the consultants to staff. I was responsible for organizing and coordinating resources that were necessary for the project, and I also negotiated with Alaska on the allocation issue.
Q. Were you personally involved in those negotiations with Alaska about the allocation issue?

A. Yes, I was.
Q. And have you reached an agreement with Alaska?
A. Not at this point.
Q. Do you have a recommendation for the Commissioner regarding a fair allocation of the stock of new Premera between the proposed Washington and Alaska Foundations, assuming that the Commissioner approves Premera's proposal?
A. I do.
Q. What is it?
A. I recommend an allocation of 85 percent for all of Washington and 15 percent for Alaska.
Q. And why is that?
A. Because this is the mid-range of recommendation from our consultants, the consultants who -- with an actuarial background, which I think is appropriate in making that determination.
Q. Have you submitted prefiled direct testimony?
A. I have.
Q. Do you adopt your prefiled direct testimony?
A. I do.
MR. HAMJE: At this time the OIC staff offers Exhibit S-38, which is Mr. Odiorne's current resume, and S-59, his prefiled direct testimony.
MR. MITCHELL: No objection.

MS. HAMBURGER: No objection.

JUDGE FINKLE: Admitted.

Q. Generally, what were your instructions to the OIC staff's consultants concerning the application?

A. They were instructed to provide a professional review of the transaction as identified in the Form A filings. They were not given specific instructions about a position to support, only report what they saw in that review. I didn't tell them bring me a report that supports. I didn't tell them bring me a report that denies.

Q. Have you formulated a recommendation regarding the action the Commissioner should take with respect to Premera's application?

A. I have.

Q. Why did you wait until now to formulate your recommendation?

A. I wanted to be sure that I had an open mind to listen to all of the testimony, see everything that was admitted, before making a recommendation. And I felt that by doing that I would be less likely to bias the consultants or the staff in their review.

Q. What sources of information have you considered in formulating your recommendation?

A. I have considered the testimony that we have heard

here over the last couple of weeks, the prefiled testimony, the exhibits, the Articles of Incorporation of Premera, whatever has been admitted here.

Q. What factors have you considered in formulating your recommendation?

A. Okay. May I look at my notes to be sure that I --

Q. Yes, please do so.

A. Generally, I considered all of the factors that are set forth in the two holding company chapters that are involved, and more specifically the five factors that the Commissioner mentioned in his opening remarks. And those are specifically Premera's financial stability, whether the transaction is fair and reasonable, whether subscribers will be treated fairly and reasonably, whether the conversion is in the interest of the insurance-buying public, and whether the conversion will lessen competition.

Q. What is your recommendation?

A. My recommendation to the Commissioner is that this transaction should be denied in its current form. But if the Commissioner feels that it should be approved, I would recommend a number of conditions to that approval.

Q. Well, let's start first with your -- with discussing your reasons for your recommendation. With respect to your recommendation, how do you define the transaction?

A. I believe the transaction is defined by the Amended Form A that's on file here, and will be further defined by the Commissioner's order.
Q. What is it about Premera's financial stability that impacts your recommendation?
A. There has been testimony in this proceeding that Premera is financially constrained in capital. There has been testimony that there is a potential for a significant adverse impact due to the potential loss of the 833b benefits.

And responding to some concerns by consultants, Premera has made some assurances that I believe could adversely impact the financial condition of Premera if they are called upon.
Q. In making a determination of whether a transaction is fair and reasonable, what information is required?
A. My impression is that before you can make a fair and reasonable determination, you have to have an absolutely complete description of the transaction that's before you.
Q. Is that present here?
A. I don't believe that it is.
Q. Please explain.
A. A significant part of the description of the transaction should be what's going to happen to the

proposed proceeds of the IPO. A significant portion of time has been devoted to testimony about the entrenchment of management and Premera's apparently overriding desire to retain local control.

When you put those two together, with the lack of a definition of what they want to do with this extra money, it seems to me that the Commissioner has been denied access to the total transaction. He only has before him a little part of it in the Form A.

Q. Does the Blue Cross/Blue Shield Association's role in this transaction have an impact on your recommendation?

A. Yes, it does.

Q. What is that impact?

A. I understood from Mr. Barlow's testimony that the Association, under its rules and guidelines, must approve the transaction, and that they have not done that at this point.

Without that approval, Commissioner is put in the position of risking the valuable Blue marks or acceding to a nongovernmental agency that was not a party to this transaction.

Q. A substantial portion of the hearing has been devoted to a discussion of the transfer of fair market value to the Foundations' shareholders. Have you

considered this issue in formulating your recommendation?
A. I have.
Q. And how has it impacted your recommendation?
A. The Articles of Premera require upon its dissolution it transfer all of its assets. The Form A suggests in different places that Premera will transfer either a hundred percent of its stock or all of the assets.

My concept of transferring assets or stock is a transfer of the full value of the company at that point. As I understand the testimony, the transfer, as it is made, takes on new restrictions, and therefore does not transfer the full value before the dissolution.
Q. Have you also considered the potential loss of the Blue marks?
A. Yes, I did.
Q. How have you considered it?
A. Well, there has been testimony that the Blue marks are a valuable asset of Premera. There has been testimony that it makes sense in some regard to maintain some restrictions on the stock in order to maintain those Blue marks. But there hasn't been an indication that it is necessary for the Foundations to totally give up their ability to vote on significant matters to Premera just to retain the Blue marks.

The testimony impressed me as saying loss of Blue marks would be a disaster. But at the same time, Premera, by the restrictions, is saying Foundations may be the major shareholders in this corporation, but you can't do anything to avoid the disaster of losing its marks.

Q. Please describe any impact the issue relating to each proposed Foundation having the right to vote five percent minus one of the new Premera stock had on your recommendation.

A. It was my understanding of Blue Cross Association rules or impositions, that an individual could own up to five percent of a Blue company, and that five-percent owner was entitled to whatever rights owners had.

In this case, Premera is insisting that two separate owners, the Washington Foundation and the Alaska Foundation, share the rights that one ownership has. So it is not fair and reasonable in respects that they are requiring somebody to give up their rights under their ownership.

Q. Is there an element of the unallocated share escrow agent agreement that you believe supports your recommendation?

A. There is.

Q. What is it?

A. As I understand the testimony on the allocated share escrow agreement, is that it requires both Foundations to sell 10 percent of their shares in the IPO, without concern as to whether it is beneficial to the Foundations, if it is the best time to sell, and that is unfair to both the Foundations in requiring them to sell at a time which may not be in their interest.

Q. In your view, did you have an observation about how Washington subscribers will be treated under Premera's proposal?

A. Yes.

Q. What is that?

A. I don't believe that they will be treated fairly.

Q. Why is that?

A. Well, to start with, the Washington subscribers are given lesser guarantees than their subscribers in Alaska, and I believe that both subscribers should have equal guarantees.

Q. Is there a potential adverse impact on subscribers in your view?

A. I believe there is. The testimony has indicated that there is potential for adverse impact on subscribers, either directly through increased premiums, or indirectly through reduced reimbursements to providers. I think it was Ms. Halvorson who testified

that the individual rates that Premera currently charges are constrained by system constraints. We have been told -- at least vaguely -- that part of the proceeds are to improve the system. And once the system is improved, I think it would be possible for those rates to float more, be more flexible, possibly be raised if there is not the constraint of the computer system.

Q. Have you taken into consideration the testimony regarding raising premiums to meet target margins?

A. Yes. There was a bit of testimony about the potential for raising that. There has been testimony on that issue, both as to raising revenue generally and as to raising premiums individually.

It appears from the testimony that I heard that that is more an issue in eastern Washington where Premera does have some market share.

Q. Are you satisfied with the economic assurances?

A. No.

Q. Why is that?

A. As I understand the economic assurances, they find Premera not to take certain actions that a company ordinarily would take to address financial issues. The actions they are foregoing would prevent them from addressing the overall financial of the company. And I think those assurances, even though they are very short,

do adversely impact the financial standing on Premera.
Q. Now, let's talk about what is in the interest of the insurance-buying public. How do you define the term insurance-buying public in the context of Premera's application?
A. From my concept of insurance-buying public, I would define it as that group of individuals, corporations, entities, that currently purchase or could purchase a healthcare service contract within Premera's operating area.
Q. How does Premera's proposal impact the insurance-buying public?
A. The testimony we have heard is that Premera will rely on growth in overall revenue, growth in membership. Focus on those two areas is a stock market shareholder focus, rather than an insurance-buying public focus.
And as we heard I think from Cal Pierson, that Blues plans that they have surveyed generally, it has been sometime prior to actually applying for conversion, and refining their membership, if you would, or certain associations that cost them too much, and they don't keep them, they get out of government programs, they raise premiums. And I think Mr. Larsen confirmed that as part of his survey also.
And we have already seen Premera doing that in this

instance. They dropped the PEBB, they are disposing of Healthy Options and Basic Health plans, and they have given notice that they are going to terminate their Medicare and intermediary status. All of those are adverse to the insurance-buying public.

Q. If the Commissioner is inclined to approve Premera's proposal, what conditions do you suggest be attached to the approval?

A. My list of conditions is fairly long, and I would like to refer to my notes on that to be sure I cover them. I think that any approval has at least three conditions as a given. First, is approval by the Alaska Commissioner, approval by the Oregon Commissioner, and approval by the Washington Attorney General as to the plan of dissolution and distribution of assets, the documents required for the creation and operation of the Foundation, and the appointment of the Foundation board.

In addition to those givens, I would suggest to the Commissioner that the following conditions be included: Receipt of a fairness opinion from the Blackstone Group, receipt and an opinion acceptable to the Commissioner from the Blackstone Group regarding IPO procedures, receipt from external consultants of bring-down opinions at the time of, but prior to, the actual conducting of the IPO that satisfies the Commissioner that no material

change has occurred in facts and circumstances relating to the Form A. The receipt and approval of an application for solicitations permit for selling the shares in the IPO. Receipt and approval of application for solicitation permit for issuing shares under the proposed executive compensation plan.

And subject to an ability to review the technical memorandum that was presented late in the proceeding, I would suggest that a condition should be receipt of a final opinion from Ernst & Young that the conversion transaction will be treated as a series of tax-free transactions for federal income tax purposes. Also subject to review of that technical memo, a receipt of a final opinion from Ernst & Young that the conversion transaction should not cause Premera to undergo a material ownership change under Section 382.

Another condition would be that there would be no adverse tax consequences arising from the loss of tax benefits under Section 833b would be passed along to policyholders. That Premera would abide by all the terms of the assurances that the Commissioner accepts, and that failure to comply with the assurances would be deemed a violation of the two holding company chapters and subject Premera to the penalties of those chapters.

That there be a closing of an IPO within 12 months

of the final approval by the attorney general in Washington, the Alaska Commissioner, the Oregon Commissioner, subject only to extensions granted by the Commissioner on application and good cause. Elimination of the requirement for the Foundations to sell down to 80 percent in the first year after the IPO. Elimination of the 10 percent required sale contained in the unallocated share escrow agent agreement. Elimination of Premera's ability to veto all Foundation nominations to the Premera board. Retaining the ability of the Foundation to have a member on Premera's board until the Foundation has less than five percent stock ownership, regardless of when that percentage level is reached.

All the assurances contained in Exhibit E-8, Form A, or provided through testimony should be included as conditions. Each Foundation must have a separate divestiture schedule. Each Foundation must have a separate five percent free vote.

In terms of the Voting Trust Agreement restricting the shareholder of voting and requiring specific divestiture must terminate upon Premera's loss of rights to use the Blue marks or upon a change in the Association rules to eliminate those restrictions. And the right of the Foundation to a free vote on any transfer or issuance of stock involving 20 percent or

more of the equity of Premera.
Q. Do you intend that this be the complete list of all the conditions?
A. As long as it is -- folks would hope -- I hope I have covered everything. It is possible we might supplement in this hearing brief that's filed after the close of the hearing.
Q. If all of these conditions are included in an order approving the transaction, would you find it acceptable?
A. I still rely on my first recommendation to the Commissioner that the transaction be denied. If the Commissioner wants to approve, then I think these conditions are minimal.
MR. HAMJE: That's all I have.
MR. COOPERSMITH: Your Honor, the Intervenors don't have any questions of this witness at this time.
THE COURT: Consistent with the previous agreement, should we adjourn for the day and resume at 9:00? Is there anything to do before we take that act?
MR. MITCHELL: Not to my knowledge.
JUDGE FINKLE: Okay. See you at 9:00.
MS. HAMBURGER: Your Honor, I just have a quick procedural question that came up. The exhibits that we discussed, the prefiled testimony to the people

who didn't testify, by your previous determination, are they automatically in the record or do we need to go through them and articulate which exhibits they are and have them -- move to have them entered?

JUDGE FINKLE: Let me hear the positions of others.

MR. HAMJE: I will go ahead and just -- go on in and make a suggestion. I would think it would be very useful at some point, we might have a little bit of a housekeeping meeting, to go ahead and talk about exhibits and making sure -- in fact, I have got one that we discovered we have a little housekeeping matter that I was talking to the Alaska Intervenors about that I would probably want to present. I would urge we maybe get together before or at some point in time and just deal with all that.

JUDGE FINKLE: Mr. Odiorne, you are free to step down.

MR. MITCHELL: Your Honor, the Alaska testimony, I think, needs to be revised before it is submitted in any form. And I tend to agree with Mr. Hamje that such matters are best addressed among the parties and we can come back to a proposal in terms of handling these exhibits.

There is one other matter that I neglected

to mention, which is I believe under the terms of the order you made on Friday, the parties are obliged by the end of the hearing today or perhaps this evening to identify rebuttal witnesses.

JUDGE FINKLE: Right.

MR. MITCHELL: What's your pleasure on that?

JUDGE FINKLE: I don't mind you having a little time, if you can agree. I mean, I would say by 5:00 or that sort of time. But if you have a different agreement, I will implement that. I think you should have a bit of time to reflect, but then you ought to be, in a reasonably quick order, able to react to others. Any position from OIC? It is 3:13.

MR. HAMJE: Well, these of course, I assume, would be potential rebuttal witnesses as much as --

THE COURT: Right. This is -- I am not expecting to argue it out. If there is an issue about identity or scope of rebuttal testimony, I will have to address that. But I am just talking about identification of names of potential rebuttal witnesses.

MR. HAMJE: May I suggest instead of 5:00 o'clock maybe 6:00 o'clock? Maybe that would be a little bit better, since some of us are not necessarily going to be going directly back to our offices or whatever.

MR. COOPERSMITH: Whatever the Court's pleasure, Your Honor.

JUDGE FINKLE: 6:00 is fine. 5:00 was plucked out as what seemed reasonable, but 6:00 is just as good. Let's say 6:00.

MR. MITCHELL: By e-mail I would assume?

JUDGE FINKLE: Sure.

MR. COOPERSMITH: Your Honor, do you -- do you anticipate then that after the conclusion of Mr. Odiorne's testimony, that we will proceed directly to rebuttal and then to closing argument?

JUDGE FINKLE: Well, with breaks -- let's exercise some good sense here. We may take an early lunch break or --

MR. COOPERSMITH: Right.

THE COURT: We may move things around a bit, but yes. In principle, yes.

MR. COOPERSMITH: Right. With regard to testimony, that will conclude the case, and then at the appropriate time we will go forward with the closing arguments?

JUDGE FINKLE: Right. And I am expecting all that to be accomplished tomorrow.

MR. COOPERSMITH: Right.

JUDGE FINKLE: And I think it is a good

suggestion to attempt to agree on the designation of the prefiled testimony, and I can address that at a break if you are unable to agree. Anything else before we adjourn? Okay. We will see you at 9:00.

MR. HAMJE: Thank you, Your Honor.

(Proceedings concluded at 3:15 p.m.)

C E R T I F I C A T E

STATE OF WASHINGTON)
) ss.
County of Pierce)

I, the undersigned Notary Public in and for the State of Washington, do hereby certify;

That the foregoing Verbatim Report of Proceedings was taken stenographically before me and transcribed under my direction; that the transcript is a full, true and complete transcript of the proceedings, including all questions, objections, motions and exceptions;

That I am not a relative, employee, attorney or counsel of any party to this action or relative or employee of any such attorney or counsel, and that I am not financially interested in the said action or the outcome thereof;

That I am herewith securely sealing this transcript and delivering the same to the Clerk of the above-entitled Court.

IN WITNESS HEREOF, I have hereunto set my hand and affixed my official seal this 19th day of May, 2004.

_____
Notary Public in and for the State of Washington, residing at Tacoma.